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UNIVERSITY OF PENNSYLVANIA

THE FEDERAL RESERVE CHECK COLLECTION SYSTEM

GORDON B. ANDERSON

A THESIS

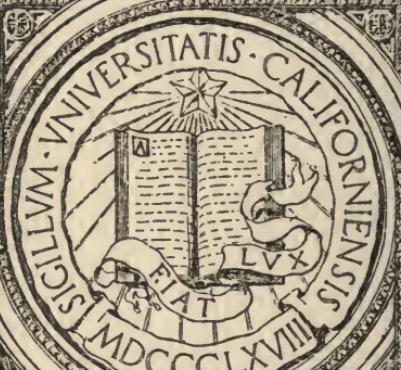
IN FINANCE

PRESENTED TO THE FACULTY OF THE GRADUATE SCHOOL IN
PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR
THE DEGREE OF DOCTOR OF PHILOSOPHY

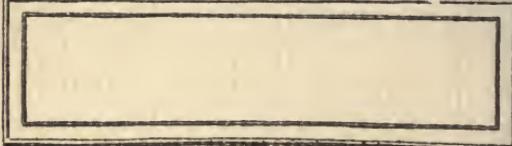
PHILADELPHIA

1917

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TO MINT
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THE FEDERAL RESERVE CHECK COLLECTION SYSTEM

In framing the Federal Reserve Act considerable attention was directed to the subject of collecting out-of-town checks. Sections 13 and 16 of the Federal Reserve Act referring to the clearing and collection functions of the Federal Reserve Banks provide as follows:

"Section 13.—. . . Any Federal Reserve Bank may receive from any of its member banks, and from the United States, deposits of current funds in lawful money, national-bank notes, Federal Reserve notes, or checks, and drafts payable upon presentation, and also, for collection, maturing bills; or solely for the purposes of exchange or of collection, may receive from other Federal Reserve Banks deposits of current funds in lawful money, national-bank notes, or checks upon other Federal Reserve Banks, and checks and drafts, payable upon presentation within its district, and maturing bills payable within its district."

"Section 16.—. . . Every Federal Reserve Bank shall receive on deposit at par from member banks or from Federal Reserve Banks checks and drafts drawn upon any of its depositors, and when remitted by a Federal Reserve Bank, checks and drafts drawn by any depositor in any other Federal Reserve Bank or member bank upon funds to the credit of said depositor in said reserve bank or member bank. Nothing herein contained shall be construed as prohibiting a member bank from charging its actual expense incurred in collecting and remitting funds, or for exchange sold to its patrons. The Federal Reserve Board shall, by rule, fix the charges to be collected by the member banks from its patrons whose checks are cleared through the Federal Reserve Bank, and the charge which may be imposed for the service of clearing or collection rendered by the Federal Reserve Bank.

"The Federal Reserve Board shall make and promulgate from time to time regulations governing the transfer of funds and charges therefor among Federal Reserve Banks and their branches, and may at its discretion exercise the functions of a clearing house for such Federal Reserve Banks, or may designate a Federal Reserve Bank to exercise the functions of a clearing house for its member Banks."

The Federal Reserve Act, as originally passed, did not provide

THE FEDERAL RESERVE CHECK COLLECTION SYSTEM

a technically adequate system for the collection of checks, with the result that the Federal Reserve Board recommended to Congress an amendment recasting the phraseology of Section 13, which was adopted in August 1916. The wording above is that of the law as then amended. The greatest change effected by the amendment was the elimination of the requirement that only checks and drafts upon "solvent member banks" might be deposited with a Federal reserve bank. It was manifestly impossible at the time a check was received by a Federal Reserve Bank to be certain that it was drawn upon a solvent bank. The Federal Reserve Bank, moreover, was protected against loss by the depositing member bank's endorsement on each check.

In addition, the revision in phraseology made certain that the Federal Reserve Banks could receive from member banks' deposits consisting in whole or in part of checks drawn upon non-member state banks. This greatly increased the value of the collection system to the member banks, particularly when the majority in number of state banks remain outside of the system. There were on March 5, 1917, 7581 national banks, all of which are members of the Federal Reserve System, and over 20,000 state banks, of which only 40 were members. Since approximately one-half of the checks received by the member banks are drawn upon non-member state banks, it became necessary to make some provision for collection of such items.

Collections Under the National Bank Act.—Under the National Bank Act national banks were divided into three groups, first, the national banks in New York, Chicago and St. Louis, designated as central reserve cities; second, national banks in fifty-two cities, known as reserve cities; third, national banks situated in other places, known as country banks. The purpose of this classification was primarily to bring about a certain degree of concentration of banking reserves. The central reserve and reserve city banks as reserve agents, carried a portion of the reserve, known as the "deposited reserve", of other banks, commonly termed correspondents. The deposited reserve is built up almost entirely through the deposit of checks which are sent by the correspondents to

their reserve agents for collection and credit. It was the common practice to credit these checks to the correspondent's account immediately upon receipt whether or not the reserve agent was able to collect them at once. Sometimes a week or more was necessary for the actual collection of a check. The aggregate of these uncollected checks was known as "the float."

Under the national banking system this "float" was of large proportions, and was necessarily increased by the indirect routing of checks and the delay in remittances. In a great many cases the same checks served as a reserve, not only for the country bank, but for the reserve city bank, inasmuch as the latter would in turn, send them to central reserve city banks for deposit and collection. The country bank upon mailing the checks would immediately count them as part of its deposited reserve. The checks would not be received by the reserve city bank for a day or more, and then the reserve city bank would forward the checks to a central reserve city bank for collection, counting this deposit as part of its own reserve. The reserve agents gave the correspondent banks immediate credit for these items, sometimes charging them exchange for the collection service rendered, and on other occasions levying an indirect charge by deferring interest until the funds were actually in hand.

Although correspondent banks received immediate credit for checks, which they deposited with their reserve agents, on the other hand, the reserve agent receiving checks drawn upon its correspondents seldom charged these items immediately against their accounts, but sent them home for collection and allowed the correspondent bank sufficient time to remit. Frequently the country bank would charge the reserve agent exchange for the checks presented on their accounts, this charge presumably covering the cost of the service rendered in honoring the checks and remitting by draft. Where the reserve agent received checks drawn upon banks which were not included among its list of correspondents, the common practice was to collect these checks in one of two ways; first, to send such checks to one of its correspondents situated in the same town or in a nearby community; second, to send the checks to a correspondent situated at some point geographically near the bank

on which the check was drawn, which correspondent had indicated on its so-called "par list" that it would take checks drawn on banks at their face value in that town. This roundabout method of collection increased the delay incident to the collection of checks and consequently exaggerated the size of the "float." It has been estimated that from one-third to one-half of the deposited reserve with reserve agents, really consisted of checks which were at the moment in the process of collection.

It is obvious that uncollected checks do not constitute a legitimate bank reserve. One of the purposes of the Federal Reserve Act is to eliminate fictitious reserves of this character, and to substitute a tangible reserve that will be available when necessary. The reduction in the reserve requirements of member banks, therefore, has really been less than would appear by a comparison of the percentages, for it will to a large degree, be offset by the elimination of the "float", or the fictitious portion of the deposited reserve under the old system.

Inauguration of the Federal Reserve Collection System.—The keystone of the Federal reserve system is the twelve Federal reserve banks, in whose hands will be centered the greater part of the reserves of the banks joining the system, known as member banks. The elimination of the old reserve agents is to be brought about gradually over a period of three years terminating in November 1917. Up to this time the member banks—comprising all the national banks and about forty out of the twenty thousand state banks—have been living under an anomalous arrangement, by which most of them are carrying their reserves in three places—in their own vaults, on deposit with the old reserve agents and on deposit with the Federal reserve banks. On and after November 16, 1917 (or earlier if an amendment recommended by the Federal Reserve Board is adopted) member banks can carry their reserves in only two places—in their vaults or on deposit with the Federal reserve banks. Thus the old reserve agents will be eliminated. It was obvious to the framers of the Act that with the elimination of the old reserve agents must come the creation of facilities which would perform the service heretofore rendered by such agents for the correspondent banks. The most important of these

services is the collection of out-of-town checks, frequently referred to as "foreign items."

The Voluntary Clearing System.—On May 15, 1915, the Federal reserve banks instituted a voluntary intra-district clearing system, which provided that the Federal reserve banks would charge immediately on receipt against the assenting member bank's account, subject to payment by such member bank, checks and drafts, payable upon presentation, deposited by other banks which had joined the system. Checks would be charged only against the accounts of those member banks which had assented to such action, from whence came the term "voluntary clearing system." Under this system each member bank had to provide sufficient funds to offset the items charged against its account. The portion of the reserve of the member bank, which the law required to be kept with the Federal reserve bank, was not to be impaired and whatever additional amount had to be kept on deposit to avoid such impairment, was to be determined by experience. Checks and drafts payable on presentation, drawn on any member bank in the district which had joined the collection system, were, subject to final payment, received for immediate credit to the depositing bank's account.

This plan is known as the reciprocal plan of immediate clearance. Each Federal reserve bank worked out its own method, based on the same general principle. At first it was purely an intra-district clearing plan, based on the principle of immediate debit and credit of items remitted to the bank for collection. Under this plan the member banks found it very difficult to gauge the excess balance, which they had to keep on deposit with the Federal reserve bank to cover items drawn on them. The Federal reserve banks, especially in the early stages of the system, had to be very lenient in the matter of deficiencies in reserves.

Comparatively few member banks took advantage of clearing their checks through the Federal reserve banks under the voluntary system. However, the large city banks cleared checks drawn on assenting banks with which they did not correspond, and in this way were able to dispose of some of their items more cheaply than under the old system. Despite the fact that the

Federal reserve banks absorbed all the costs involved, the voluntary plan of check collection was not a success. The member banks were still operating under a dual system of reserves. The reserve balances which the country banks carried with their old reserve agents still compensated the latter for the collection service rendered. Comparatively few banks agreed to the terms of the voluntary system, and the provision of the law since changed, which provided that only items on members of the clearing system could be handled, limited its usefulness. The need of including outside checks within the scope of operations, was obvious. Again, the bankers felt that the Federal reserve banks ought to assume the "float," but this, the Federal Reserve Board refused to sanction; pointing out that this would perpetuate the unsatisfactory procedure of making a large part of the deposits of the Federal reserve banks, float.

The serious inroads that would be made upon the deposits of the Federal reserve banks if they assumed the "float," can readily be demonstrated by an example. In the month from March 16, to April 15, 1917, the average daily collections passing through the twelve Federal reserve banks, consisted of 231,800 items, aggregating \$127,648,500. Of this \$67,360,500, or 52.7 per cent required from two to nine days for collection. Presuming, for the sake of illustration, that the average time of collection was three days, the "float" would, therefore, be in excess of \$200,000,000. The maximum deposits of the member banks with the Federal reserve banks reported in this period was \$758,219,000.

Inauguration of the Compulsory Collection System.—After the Federal reserve banks had operated the voluntary system of clearing for a year the Federal Reserve Board inaugurated the compulsory plan, which was put into operation July 15, 1916. In a statement to the press the salient features of the plan were stated as follows:

- "(1) The Federal Reserve Banks will accept at par all checks from member banks, whether drawn against other member banks, non-member banks, or private banks. An exception is made at the outset in the case of checks drawn against non-member banks which can not be collected at par.

"(2) All checks thus received from member banks will be given immediate credit entry, although amounts thus credited will not be counted as reserves nor become available until collected.

"(3) In order to enable member banks to know how soon checks sent in for collection will be available either as reserves or for payment of checks drawn against them, time schedules, giving the minimum time for collection, will be furnished by each Federal Reserve Bank to its member banks.

"(4) The actual cost, without profit, of the clearing and collection of checks will be paid by the Federal Reserve Banks and assessed against the member banks in proportion to their sendings.

"(5) The whole plan is based on generally accepted principles under which clearing and collection plans have long been operated. A Federal Reserve Bank will not debit a member bank's reserve account with items forwarded to it for collection until the remittance of the member bank in payment of such items, shall have had time to reach the Federal Reserve Bank."

Under this system member banks are free to continue accounts with their city correspondents and in fact, none of the old collection machinery need be disturbed. The collection plan is not compulsory upon any bank so far as the use of facilities to be provided is concerned. They are compelled, however, to remit at par for all checks presented at their own counters. This includes checks sent to them by the Federal reserve bank directly through the mails. Member banks can remit by draft, either on the reserve bank or on a bank acceptable to the reserve bank, or in cash. In case cash is remitted, that is to say lawful money of the United States or Federal reserve notes (anything except national bank notes), the Federal reserve bank will pay the transportation charges.

For member banks which send checks to the Federal reserve bank for collection, a small service charge is made. This charge is based on a flat rate per item and varies from two cents per item, the charge of the San Francisco Reserve Bank and the maximum charge allowed by the Federal Reserve Board, to nine-tenths of one cent per item, the charge of the Boston Reserve Bank. Most reserve banks have fixed the service charge at $1\frac{1}{2}$ cents per item. Between all Federal reserve banks a charge of $1\frac{1}{2}$ cents per item is made. The service charges were determined after a canvass of the experience

of the old reserve agents. If later experience of the Federal reserve banks show that the charges are too high, reductions will doubtless be made. Practically all of the reserve banks are at present collecting checks at a cost considerably below the service charge.

Collection Charges and Costs.—Some people have misinterpreted this service charge as being in violation of the provision of the Federal Reserve Act, requiring Federal reserve banks to receive checks for deposit at par. As a matter of fact, checks are immediately credited at par, the service charge being calculated for each bank at the end of the month; a statement being rendered to each depositing bank of the charges against it, giving the number of checks received each day and the total for the month. With but one exception the two-cent service charge is ample—but in case of district twelve, the reserve bank must absorb part of the cost of the collection business. The service charge imposed per item and the cost of collection for each of the twelve banks during the period from July 15, 1916, to December 31, 1916, are shown on page 11.

The law did not contemplate that the collection service should be done gratis, either on the part of the member bank for its customers or by the Federal Reserve Bank. The law specifically gives the Board power to regulate charges in both instances, but on the other hand clearly indicates that the charge shall represent the cost only—the item of profit being eliminated. So far, the Board has not seen fit to regulate the charges made by member banks to their depositors.

The transit departments of all Federal reserve banks are substantially similar, closely resembling the transit departments of the larger city banks. In fact, the Federal reserve banks when installing their transit departments had the advantage of the co-operation of the city banks. In the case of Boston, the Federal reserve bank took over in its entirety the staff and quarters of the Boston Clearing House. In practically every other case the Federal reserve transit departments number among their clerical force experienced transit men, coming from the banks in the city in which the reserve bank is located. The plan of organization and the methods employed in the collection

FEDERAL RESERVE BANK	TOTAL NUMBER OF ITEMS HANDLED	TOTAL AMOUNTS HANDLED	DISBURSEMENTS, TRANSIT DEPARTMENT	COST PER ITEM HANDLED	COST PER THOUSAND DOLLARS	SERVICE CHARGE PER ITEM
Boston.....	*4,847,745	\$1,002,784,224	\$40,674	.84	4.05	.9
New York.....	4,908,674	3,025,978,000	35,153	.72	1.16	1.0
Philadelphia.....	3,506,676	1,837,524,767	34,241	.98	1.86	1.5
Cleveland.....	1,996,122	957,386,775	23,394	1.17	2.44	1.5
Richmond.....	2,020,065	891,077,800	21,311	1.05	2.43	1.25
Atlanta.....	1,602,095	494,368,004	17,576	1.10	3.57	1.5
Chicago.....	*2,586,871	1,599,624,220	26,921	1.03	1.68	1.5
St. Louis.....	2,234,060	1,008,756,505	11,890	.53	1.17	1.5
Minneapolis.....	1,529,407	329,826,404	17,068	1.12	5.17	1.5
Kansas City.....	1,562,860	845,154,257	15,241	.98	1.80	1.5
Dallas.....	1,495,626	378,491,987	19,497	1.31	5.15	1.5
San Francisco.....	594,475	167,287,612	28,525	4.80	17.00	2.0
Total.....	28,884,676	\$12,538,260,555	\$291,491	1.01	2.32	...

*Does not include Government checks.

departments of the several reserve banks do not vary sufficiently to necessitate a detailed description of each. The collection department of the Federal Reserve Bank of Philadelphia is used as the basis of this study. Important variations in the methods followed by the other reserve banks are noted wherever they occur.

Regulations Governing Collection Service.—The collection activities of the Federal reserve banks are now being conducted under Federal Reserve Board Regulation J, Series 1916, which reads as follows:

"The Federal Reserve Board is empowered, under section 16, of the Federal Reserve Act, to require each Federal Reserve Bank to:

"Exercise the function of a clearing house for its member banks."

"In pursuance of the authority vested in it under the provisions of this section, the Federal Reserve Board, desiring to afford to both the public and the various member banks a direct, expeditious, and economical system of check collection and settlement of balances, hereby requires all Federal Reserve Banks to exercise the functions of a clearing house for their respective member banks under the following general terms and conditions:

"Each Federal Reserve Bank will receive at par from its member banks checks* drawn on all member banks, whether in its own district or other districts, and checks drawn upon non-member banks when such checks can be collected by the Federal Reserve Banks at par.

"Each Federal Reserve Bank will receive at par from other Federal Reserve Banks checks drawn upon all member banks of its district and upon all non-member banks whose checks can be collected at par by the Federal Reserve Bank. The Federal Reserve Banks will prepare a par list of all non-member banks, to be revised from time to time, which will be furnished to member banks.

"Immediate credit entry upon receipt subject to final payment will be made for all such items upon the books of the Federal Reserve Bank at full face value, but the proceeds will not be counted as part of the minimum reserve nor become available to meet checks drawn until actually collected in accordance with the best practice now prevailing.

* A check is generally defined as a draft or order upon a bank or banking house, purporting to be drawn upon a deposit of funds, for the payment at all events of a certain sum of money to a certain person therein named, or to him or his order, or to bearer, and payable instantly on demand.

"(2) Checks received by a Federal Reserve Bank on its member banks will be forwarded direct to such member banks and will not be charged to their accounts until advice of payment has been received or until sufficient time has elapsed within which to receive advice of payment.

"(3) In the selection of collecting agents for handling checks on non-member banks member banks will be given the preference.

"(4) Under this plan Federal Reserve Banks will receive at par from their member banks checks on all member banks and on non-member banks whose checks can be collected at par by any Federal Reserve Bank. Member banks will be required by the Federal Reserve Board to provide funds to cover at par all checks received from or for the account of their Federal Reserve Banks: Provided, however, That a member bank may ship lawful money or Federal Reserve notes from its own vaults at the expense of its Federal Reserve Bank to cover any deficiency which may arise because of and only in the case of inability to provide items to offset checks received from or for the account of its Federal Reserve Bank.

"(5) Section 19 of the Federal Reserve Act provides that:

"The reserve carried by a member bank with a Federal Reserve Bank may, under the regulations, and subject to such penalties as may be prescribed by the Federal Reserve Board, be checked against and withdrawn by such member bank for the purpose of meeting existing liabilities: Provided, however, That no bank shall at any time make new loans or shall pay any dividends unless and until the total reserve required by law is fully restored."

"It is manifest that items in process of collection can not lawfully be counted as part of the minimum reserve to be carried by a member bank with its Federal Reserve Bank. Therefore, should a member bank draw against such items the draft would be charged against its reserve if such reserve were sufficient in amount to pay it; but any resulting impairment of reserves would be subject to all the penalties provided by the act.

"Inasmuch as it is essential that the law in respect to the maintenance by member banks of the required minimum reserve shall be strictly complied with, the Federal Reserve Board, under authority vested in it by section 19 of the act, hereby prescribes as the penalty for any deficiency in reserves a sum equivalent to an interest charge on the amount of the deficiency of 2 per cent per annum above the ninety-day discount rate of the Federal Reserve Bank of the district in which the member bank is located. The Board reserves the right to increase this penalty whenever conditions require it.

"Member banks can at all times arrange to keep their reserves intact by rediscounting with their Federal Reserve Bank.

"(6) Each Federal Reserve Bank will determine by analysis the amounts of uncollected funds appearing on its books to the credit of each member

bank. Such analysis will show the true status of the reserve held by the Federal Reserve Bank for each member bank and will enable it to apply the penalty for impairment of reserve.

"A schedule of the time required within which to collect checks will be furnished to each member bank to enable it to determine the time at which any item sent to its Federal Reserve Bank will be counted as reserve and become available to meet any checks drawn.

"(7) In handling items for member banks, a Federal Reserve Bank will act as agent only. The Board will require that each member bank authorize its Federal Reserve Bank to send checks for collection to banks on which checks are drawn, and, except for negligence, such Federal Reserve Bank will assume no liability. Any further requirements that the Board may deem necessary will be set forth by the Federal Reserve Banks in their letters of instruction to their member banks.

"(8) The cost of collecting and clearing checks must necessarily be borne by the banks receiving the benefit and in proportion to the service rendered. An accurate account will be kept by each reserve bank of the cost of performing this service and the Federal Reserve Board will, by rule, fix the charge, at so much per item, which may be imposed for the service of clearing or collection rendered by the reserve banks, as provided in section 16 of the Federal Reserve Act.

In addition to the Board's regulation, copies of which were sent to the Federal reserve banks and member banks alike, each of the twelve Federal reserve banks promulgated a series of rules and regulations governing member banks, and state banks having relations with its collection department. These relations are generally identical. Those promulgated by the Federal Reserve Bank of Philadelphia, issued under date of June 9, 1916, are in part as follows:

"... Accordingly, under the authority of the Federal Reserve Act, and by direction of the Federal Reserve Board, the Federal Reserve Bank of Philadelphia will inaugurate on July 15, 1916, a system for collecting checks drawn on banks located in all sections of the United States. On and after said date this Bank will receive on deposit at par from its member banks, checks on all member banks in the United States wherever situated and in addition checks on all non-member banks in the United States which can be collected by Federal reserve banks at par. A list of the latter banks will shortly be forwarded to you and revisions thereof will be issued from time to time. Imme-

diate credit entry will be made for all items received, subject to final payment. The proceeds of such items will not, however, be available for withdrawal, nor count as reserve until the lapse of time indicated in the attached schedule, which for your convenience has been divided into four groups, with divisions according to State lines, rather than Federal reserve districts. On the other hand, items forwarded for payment to banks in this district will not be charged to the account of paying banks until the second business day after they have been forwarded by this Bank; thus enabling the member bank to calculate accurately the amount necessary to be sent us to maintain its average reserve unimpaired. A careful study of the following description of the plan of operation will enable you to avail yourselves of the collection service.

"Exchange Charges.—Since the Federal Reserve Act requires Federal reserve banks to receive checks on their member banks on deposit at par, the Federal Reserve Board will not permit Federal reserve banks to pay or allow any exchange charges, and as the proposed plan is a reciprocal clearing arrangement, member banks must therefore cover at par all checks drawn upon themselves received from us or for our account, since such checks will have been accepted by us on deposit at par.

"In case a member bank fails to receive from its customers in the regular course of business checks on other communities sufficient in amount to offset the checks on itself forwarded by us, and recognizing the principle that all checks are payable only at the counter of the bank on which they are drawn, the privilege will be given to member banks to ship us lawful money or Federal reserve notes from their own vaults at our expense to cover checks received from us or for our account.

"Items Forwarded.—Items on member banks in this district will be forwarded direct to the paying banks and will be charged to their accounts on the second business day after the date of sending, thus allowing us time to receive advice of payment.

"Liability.—Every member bank forwarding to us items referred to herein will be understood to have agreed to the terms and conditions set forth in this circular. In receiving such items, the Federal Reserve Bank of Philadelphia will act only as the collecting agent of the sending bank, assuming no responsibility other than the exercise of due diligence until the funds are actually in its hands. The Federal Reserve Bank of Philadelphia is authorized to send such items for payment direct to the banks on which they are drawn. There shall be no liability on the part of the Federal Reserve Bank of Philadelphia by reason of its not having collected any such items in cash, or because of its inability to return any such items to the member banks from which they were received. In the event of the suspension or insolvency of the bank on which any such items are drawn the Federal Reserve Bank of Philadelphia is author-

ized to charge the proportionate amount of any and all items for which it has not received payment to the account of the member banks from which such items were received.

"Restrictions as to Endorsements.—In the interest of good banking, the indirect routing of items will be discouraged, and member banks will not be allowed to deposit with us items payable in other districts which bear the endorsement of member banks located outside of this district.

"District Routine.—Whenever time can be saved and the volume of business between points located within or without the district warrants direct interchange of items, such direct interchange will be encouraged. Balances arising from such methods of collection may be settled by drafts on a Federal reserve bank.

"Non-member Bank Checks.—Letters will be sent to all non-member banks in this district offering them the opportunity to remit at par on receipt for checks on themselves either in satisfactory exchange, or by shipments of currency at the expense of the Federal reserve bank. Since it is desirable to give preference to member banks in the collection of non-member items, we recommend that you make mutually satisfactory arrangements with the non-member banks in your community for the collection of non-member items and advise us of the conclusions reached.

"Service Charge.—The Federal Reserve Act provides that charges to be fixed by the Federal Reserve Board may be imposed for the service of collection rendered by the Federal reserve banks.

"Under this authority the Federal Reserve Board has fixed a service charge of $1\frac{1}{2}$ cents per item, to be made for the depositing bank and to be debited to the member bank's account monthly, such service charge to be based on the estimated actual cost of handling the items. No service charge will be made to member banks in this district on items payable in Philadelphia.

"It is hoped that as the system develops the cost of operation will tend to decrease and that it will soon be possible to reduce the service charge. This will largely depend on the cordial co-operation of the member banks.

"Sorting.—Careful sorting of items on the part of member banks will materially reduce the handling by this Bank and the saving in expense will therefore tend to reduce the service charge.

"Items sent for credit should be divided into the following five classes and listed on separate sheets:

- "1. Items immediately available as per accompanying schedule.
- "2. Items drawn upon one-day points, as per accompanying schedule.
- "3. Items drawn upon two-day points, as per accompanying schedule.
- "4. Items drawn upon four-day points, as per accompanying schedule.
- "5. Items drawn upon eight-day points, as per accompanying schedule.

"District Number.—Member banks and those non-members which have agreed to remit at par, are urged to have imprinted on their checks the number '3' in large skeleton figures in the center of the check. It is important that this be done as quickly as possible, as the use of the district number will facilitate the sorting of checks, thereby tending towards a reduction in the service charge. It is also suggested that the words:

"COLLECTIBLE AT PAR THROUGH THE FEDERAL RESERVE BANK OF PHILADELPHIA"

be stamped or printed on all checks drawn on member banks in this district and on those non-member banks in this district, which have agreed to remit at par.

"Penalty for Deficient Reserves.—In order that we may know that member banks maintain adequate reserves with us, you are requested to report to us at the end of each month, on forms to be furnished, the average reserves required of your bank to be on deposit with us for the month. The Federal Reserve Board circular provides for the assessment of penalties for impairment of reserves and a penalty rate for such impairment has been fixed at 2 per cent above the discount rate of this bank for 90-day paper, but in no case less than 6 per cent.

"Protest Instructions.—It is recommended that all cash letters bear substantially the following instructions governing the protest of items:

"Protest all items over \$10.00 except those bearing the stamp N.P. 3-4 or similar authority of a preceding bank endorser.

"Telegraph non-payment of items of \$500.00 or over."

"Items bearing other special instructions should be forwarded in a separate letter.

"Time for Receiving Items.—Immediate credit entry subject to final payment will be given for all items received each day before 2.00 P. M. (except Saturday when the hour will be 12 noon), items received after these hours will be included in the following day's business. Unpaid items not subject to protest must be returned on the day after receipt. Unpaid items must not be held for any purpose except for immediate protest. Returned items should be sent direct to depositing bank with advice to us. Protested items should not be forwarded a second time as cash items.

"Method of Endorsing Items.—All items forwarded to the Federal Reserve Bank of Philadelphia, must be endorsed without restriction to the order of the Federal Reserve Bank of Philadelphia, with all prior endorsements guaranteed, and show on each side of the endorsement stamp the American Bankers' Association transit number in prominent type.

"An endorsing stamp will be furnished to each member bank.

"In due course, letters will be sent to member banks suggesting methods of accounting, forms of remittance letters, etc.

"The Federal Reserve Bank of Philadelphia reserves the right to add, alter, or amend the foregoing plan of operation."

The Time Schedules.—The term clearing cannot be correctly applied to the present operations of the Federal reserve check collection system. Checks are not exchanged nor are differences between banks settled. The system differs from the operations of the voluntary plan and the City Department of the ordinary clearing house. The reserve banks maintain a collection department or transit department, which collects checks deposited by their members. Technically the bank acts as agent for its member bank customer, receiving the items for collection; credit being given immediately, but this credit is available only after the remittances have been received for the items from the banks on which they are drawn. It can be accurately determined when remittances will be received, so for convenience, a time schedule is arranged informing the depositing banks when the proceeds of deposited items will be available. The time schedules for all the Federal reserve banks diagrammatically expressed, appear on page 19.

This chart shows when the proceeds of a check drawn on any point in the United States are available, except checks drawn on banks in District No. 11. With the exception of Districts No. 1, Boston, No. 2, New York and No. 12, San Francisco, only items drawn on member banks and banks as listed in a printed schedule, which have agreed to remit at par, can be deposited with the Federal Reserve Banks. These schedules will be referred to later. The object of this chart is to show when the funds created by the deposit of foreign items in a Federal reserve bank are available for use by the member. For example, a bank in Maine sends to the Federal Reserve Bank of Boston items drawn on a bank in Alabama; the chart shows four days—that is four days after receipt by the Boston Reserve Bank—the funds will be available for use by the depositing Maine bank. Items on California require eight days, including items on San Francisco, the Federal reserve city for this

AVAILABILITY SCHEDULES FROM PAR LISTS, JANUARY, 1917

Alabama	4	8	4	8	Wyoming
Arizona	4	8	4	8	Wisconsin
Arkansas	4	6	4	6	West Virginia
California	4	8	4	8	Washington
Colorado	4	8	4	8	Virginia
Connecticut	4	8	4	8	Utah
Delaware	2	4	2	4	Texas
Florida	2	4	2	4	Tennessee
Georgia	2	4	2	4	Rhode Island
Hawaii	2	4	2	4	South Carolina
Iowa	2	4	2	4	North Dakota
Kansas	2	4	2	4	Pennsylvania
Louisiana	2	4	2	4	Utah
Maine	2	4	2	4	Montana
Maryland	2	4	2	4	Minnesota
Massachusetts	2	4	2	4	Mississippi
Michigan	2	4	2	4	New Mexico
Minnesota	2	4	2	4	New Jersey
Mississippi	2	4	2	4	New Hampshire
Missouri	2	4	2	4	North Carolina
Montana	2	4	2	4	North Dakota
Nebraska	2	4	2	4	Oklahoma
Nevada	2	4	2	4	Oregon
New Hampshire	2	4	2	4	South Dakota
New Jersey	2	4	2	4	West Virginia
New Mexico	2	4	2	4	Utah
New York	2	4	2	4	Utah
Ohio	2	4	2	4	West Virginia
Oklahoma	2	4	2	4	Utah
Oregon	2	4	2	4	Utah
Pennsylvania	2	4	2	4	Utah
Rhode Island	2	4	2	4	Utah
South Carolina	2	4	2	4	Utah
Tennessee	2	4	2	4	Utah
Utah	2	4	2	4	Utah
Vermont	2	4	2	4	Utah
Virginia	2	4	2	4	Utah
Washington	2	4	2	4	Utah
West Virginia	2	4	2	4	Utah
Wisconsin	2	4	2	4	Utah
Wyoming	2	4	2	4	Utah

*Checks on all Federal Reserve Bank Immediate Credit (*i.e.* Richmond and San Francisco).

district. Items on Illinois require four days, but those on Chicago—the seat of a Federal reserve bank—require two days. The differences are due to the time required to forward the items for collection and receive a remittance therefor by mail.

Organization of the Collection Department.—The collection or transit department of the Federal Reserve Bank of Philadelphia is under the supervision of the cashier and directly in charge of a transit manager, who has under his jurisdiction thirty-five clerks. The equipment consists of thirty-five duplex adding and listing machines and six listing machines with a typewriter attachment designed to describe the items, one electric letter opener, one electric endorsing machine, and one electric letter sealing machine. These are contained in a room 25' x 60', two walls of which are a solid line of sorting racks. In the center of the room are long tables with another row of tables at one end making a T-shaped arrangement.

The plan contemplates two transit settlements each day, namely, the morning or A. M. settlement and the afternoon or P. M. settlement. The mail which arrives at the bank before nine o'clock and also all deposits received from the Philadelphia banks before this time are included in the morning work. The mail which arrives at the bank after nine o'clock, as well as the checks received from city bank messengers after that time, are held over for the afternoon work. The reserve bank will accept all deposits until 2.00 P. M., but after that time and until 3.30 P. M. will accept only items of \$1,000 and over; all checks arriving after 2.00 P. M., except those of \$1,000 and over which arrive at the reserve bank before 3.30 P. M., will be held over until the next morning.

On Saturday the first settlement is conducted as usual; the second differs, however. The incoming mail closes at 11.00 A. M. and deposits from local banks at 12.00 M., instead of 2.00 P. M. No provision is made for later receipt of items of \$1,000 and over. At present the need for a regulation covering the later receipt of large checks on Saturday, has not arisen.

Receiving and Sorting the Mail.—The early mail is brought to the bank from the Post Office by a messenger at 2.00 A. M. The Philadelphia banks deliver their checks to the Federal

reserve bank at different times, credit being entered in a pass book for the aggregate of each batch as deposited. Practically all of the morning city banks' deposits are received by the transit department before 9.00 o'clock. Some are delivered late the preceding afternoon; others usually before 8.00 o'clock in the morning. Four clerks report for duty in the transit department at 6.00 A. M., so that the work on these early deposits will be well under way and the bulk of the mail opened and properly sorted for the remainder of the force to work upon when they arrive two hours later. This sorting is done on ordinary tables and consists of arranging the incoming mail into five divisions conforming to the five general ledger divisions of the bookkeeping department:

1. Those letters coming from banks located in towns of Pennsylvania whose names begin with the letters A to D; banks in Delaware and that part of New Jersey included in District No. 3.
2. "Pennsylvania E to O."
3. "Pennsylvania P to Z."
4. Other Federal reserve districts.
5. Non-member state bank remittances.

Then the envelopes are opened and the mail is checked as hereafter described, and made up into batches. The envelopes contain the checks sent for collection and credit by a particular member bank. These checks are drawn on member banks situated throughout the United States, and on such non-member banks as have agreed to remit at par to the Federal reserve bank of their district. Each member bank, as we have seen, is supplied from time to time by the Federal Reserve Board with printed schedules, in which are listed by Federal reserve districts, sub-divided according to states, towns and cities, all banks in the United States which remit at par to the Federal reserve bank of their district. The lists contain the names of all the members of the Federal reserve system, and in addition they contain the names of all state institutions which have made arrangements, through a member bank or directly with a Federal reserve bank, to remit at par to the Federal reserve bank of their district for all checks presented to them. On

April 15, 1917, checks on 8,607 non-member state banks, in addition to the 7,625 national and state member banks, were collected at par by the Federal reserve banks—a total of 16,232 banks, or approximately 60 per cent of the total banks of all classes in the United States. Three out of the twelve Federal reserve banks—those situated in New York, Boston and San Francisco—accept checks on every bank in their district.

The Cash Letter.—A cash letter, as it is called, accompanies each bank's daily deposit of checks.

The depositing bank is requested, in making up its cash letter, to describe the bank upon which each check is drawn, either by inserting the name or the number of such bank, according to the universal numerical system adopted by the American Bankers' Association, and to insert opposite the name or number the amount called for by the check. The regulations of the Federal reserve bank further require that all items forwarded for collection "must be endorsed without restriction" to the order of the Federal reserve bank to which they are sent "with all prior endorsements guaranteed and show on each side of the endorsement stamp, the American Bankers' Transit number in prominent type." The Federal reserve bank will furnish to each member bank a suitable endorsing stamp. The form of the endorsement is substantially as follows:

Pay to the order of
FEDERAL RESERVE BANK OF PHILADELPHIA
Prior Endorsements Guaranteed,

3-20

May 5, 1917

3-20

FIRST NATIONAL BANK, PHILADELPHIA, PA.

3-4

Pay to the Order of
Any Bank, Banker or Trust Co.,
Prior Endorsements Guaranteed.

3-4

FEDERAL RESERVE BANK OF PHILADELPHIA

It will be observed that the above endorsement is a double endorsement, the upper half constituting the endorsement to the Federal reserve bank by the member bank and the lower half constituting the endorsement by the Federal reserve bank to "any Federal reserve bank or member bank." By having one stamp containing both endorsements the reserve banks are saved the work of putting all checks sent to them for collection through the endorsing machine. Checks collected through the local clearing house must be put through the machine by the reserve bank, as hereafter described.

The depositing bank in making up its cash letter is urged to arrange its items in groups according to the date on which the funds will be available, under the rules of its Federal reserve bank. The time schedule of the several Federal reserve banks has been heretofore given. In order to illustrate the working of this schedule, which is in reality a composite of the schedules of the several banks, the time schedule of the Federal Reserve Bank of Philadelphia is here inserted.

FEDERAL RESERVE BANK OF PHILADELPHIA

On Receipt

CITIES

Philadelphia New York

ONE BUSINESS DAY AFTER RECEIPT

Boston

Richmond

TWO BUSINESS DAYS AFTER RECEIPT

STATES

CITIES

Atlanta
Chicago
Cleveland
Kansas City
Minneapolis
St. Louis

Connecticut
Delaware
District of Columbia
Maine
Maryland
Massachusetts*
New Hampshire

New Jersey
New York*
Pennsylvania*
Rhode Island
Vermont
Virginia*

FOUR BUSINESS DAYS AFTER RECEIPT

Dallas
New Orleans

Alabama
Arkansas
Florida
Georgia*
Illinois*
Indiana*
Iowa
Kansas
Kentucky
Michigan

Minnesota*
Mississippi
Missouri*
North Carolina
Ohio*
South Carolina
Tennessee
West Virginia
Wisconsin

EIGHT BUSINESS DAYS AFTER RECEIPT

San Francisco	Arizona	North Dakota
	California	Oklahoma
	Colorado	Oregon
	Idaho	South Dakota
	Louisiana*	Texas*
	Montana	Utah
	Nebraska	Washington
	Nevada	
	New Mexico	Wyoming

This schedule, as has previously been stated, is constructed on the basis of the time required to forward checks by mail to the banks upon which they are drawn and to receive a remittance from them in the same fashion.

In brief, the time sheet provides that the deposit created by checks sent to the Philadelphia Reserve Bank is available for use by the member bank either immediately, or in part after one, two, four or eight business days have elapsed. The depositing bank is required to arrange its items to conform with this schedule. In listing the deposit a total for each class of credit must be listed, and the checks contained in the deposit separated into batches by the use of a rubber band to conform with the time divisions on the latter. Sub-totals of each division and the grand total of the contents of each package are given.

In ticking off or checking the incoming cash letter, each check is not compared with the listing on the letter, the liability of error being so small that it does not pay to check each item on the latter, for if a mistake has been made by the depositing bank it will be detected later when the checks are listed on the batch sheets. Only the first and last items are scrutinized, to be certain that the sending bank has made no mistake either in enclosing the wrong cash letter, the wrong batch of checks, or in misaddressing the envelope. If the sending bank has not described the checks by inserting the names or universal numerical system symbols of the drawee banks, the omission is corrected at this time. The transit department does not check the cash letter as to the arrangement of the items according to the time schedule. Incorrect time listing can be detected by the analysis department when checking up particular accounts.

* Except cities as listed.

Up to this point the contents of each cash letter still remain intact, the sorting thus far being confined to a classification of cash letters according to the points of origin of the letters. For instance, the First National Bank of Scranton's letter will be received, placed on the space on the sorting table allotted to "Pennsylvania P to Z," then opened by one of the clerks who arrives at 6.00 o'clock in the morning and examined to see whether the proper package of checks is enclosed.

Making Up and Sorting the Batches.—While checking the incoming mail the clerk divides the mail in each division into batches. One or more cash letters aggregating a pile of checks about three inches in height, weighing approximately one pound and containing in the neighborhood of four hundred items, usually constitutes a batch. On the preceding afternoon the necessary number of batch sheets are prepared. The batch sheet is a piece of blank paper 12" x 19", which is stamped on the lower right-hand corner as follows:

Sorted by.....	
Listed by.....	
Settled by.....	
E—O	No.....

These batch sheets are of five kinds; (1) Delaware and New Jersey; Pennsylvania A—D; (2) Pennsylvania E—O; (3) Pennsylvania P—Z; (4) Reserve, and (5) "Due Froms" that is, remittances from state banks not members of the Federal reserve system, which have agreed to remit at par, and are making settlement for checks previously sent to them. Each batch sheet is numbered so that a missing sheet may be detected later in the make-up of the settlement sheet.

A batch of items is wrapped in a blank batch sheet, secured with a rubber band, and passed to a sorting clerk. For the sake of simplicity, assume for the present, that the batch contains but one cash letter, meaning that a member bank has sent in a letter accompanied by approximately four hundred items. This is often the case. In some instances one cash letter, because of its size, may be divided into two or more batches. On the other hand as many as ten or more small cash letters are made up on

one batch sheet. The make-up of the batch sheets, as has been said, is primarily based on the quantity of checks, and not the final disposition of the items. The sorting clerk now takes the batch and proceeds to break up the portion of cash letter, or the cash letters contained therein, sorting down the checks into the following divisions:

1. Items payable through Philadelphia Clearing House.
2. Run (items drawn on banks and bankers in Philadelphia, not members of the Clearing House).
3. Federal Reserve Bank of Philadelphia.
4. Return items.
5. Delaware and New Jersey.
6. Pennsylvania A—D.
7. Pennsylvania E—O.
8. Pennsylvania P—Z.
9. Other Philadelphia (outlying banks and trust companies).
10. Eastern (New York State and New England).
11. Other reserve districts.

A word of explanation concerning the above classification may be helpful. "Items payable through the Philadelphia Clearing House" include checks drawn upon banks situated in the City of Philadelphia and members or associate members of the clearing house. The division "Federal Reserve Bank of Philadelphia" includes drafts drawn by member banks against their deposits with the reserve bank. These drafts largely represent remittances for checks previously sent out for collection, the draft being included as a part of the cash letter of the member bank. "Return Items" constitute checks previously sent out for collection but which have been returned by the bank on which they are drawn because of a variety of reasons, as for example, because the person drawing the check has no account with the bank on which he has drawn. Such "return items" it will be observed, are included in the deposit of the bank for the current day, and under the rules, constitute items for which immediate credit will be given. The Federal reserve bank will return them in the day's collection to the institution

which had originally sent them in for collection, immediately charging them therefor. In making this immediate charge the transit department fills out and sends a duplicate advice, the original of which goes to the member bank together with the checks sent out that day for collection. The duplicate goes to the bookkeepers as the basis of the debit entry.

The "Eastern Division" includes the checks drawn on all banks situated in New York State and in New England. This division is made separately from that of "other reserve districts", because of the large volume of checks to be collected on New York and New England points. All checks drawn on banks in reserve districts other than New England (District No. 1) and New York (District No. 2)—whether drawn against Federal reserve banks or any member bank or the state institutions situated in such districts which have agreed to remit at par, are included in the division "other reserve districts." All such checks are sent for collection to the Federal reserve bank for each particular district. It is altogether likely that, as the volume of inter-district business continues to grow, this latter group will be sub-divided in order to facilitate the work.

After a clerk has sorted the batch he hurriedly goes over the sorting to correct any missorts which may have crept in. The sorting clerk then initials the "sorted by" in the lower right-hand corner of the batch sheet.

Listing the Batches.—The batch now goes to a listing clerk, who inserts the blank batch sheet into a duplex adding machine and lists all checks for the Clearing House in one column, printing the total, the duplex machine transferring the total of these checks to the lower counter of the machine. Likewise all the checks for the "Run" are listed in another column. A total is struck, this total being transferred and added to the clearing house total and carried in the lower counter. The other divisions are similarly run up in turn, the grand total being carried as described above, and finally printed when the listing of the batch is completed. The completed sheet shows the checks in their proper columns with the total for each column and a grand total for all the columns on the sheet. This grand total must agree with the total of the cash letter, which in this illustration

made up the batch. Each column is then properly marked by the listing clerk, namely Clearing House as C. H., Run, R., Pennsylvania A—D, A—D, etc. These captions are necessary, because no particular order is followed in listing the divisions nor does each batch necessarily contain checks for each transit division. In case the grand total on the batch sheet agrees with the total on the cash letter, the listing clerk then initials "listed by" and turns the completed batch sheet and the checks over to the settling clerk. In case the listing clerk finds, after he has run up the batch sheet, that the total of the batch sheet and the total of the cash letter does not agree, he immediately checks back his work. If he does not locate the error he turns it over to the settling clerk who must locate and reconcile the difference before the particular batch is run through the department. This may involve locating an error on the batch sheet or the cash letter may be at fault. If the letter is incorrect, the letter is changed and a memorandum is made of the essential information so that the Federal reserve bank may write to the member bank in question advising it of the mistake.

Should more than one cash letter be included in the batch, the checks are sorted and listed in the same manner as described above, and when the listing is completed the aggregate totals of the cash letters must agree with the grand total of the batch sheet. The totals of the cash letters are listed separately on the batch sheet and each total is followed by the name of the bank which sent the letter. If the aggregate totals do not agree the work must be checked back and the error located and corrected. In view of the fact that making up the batch sheets will disclose any errors which may have been made by the banks in their cash letters, the mail is not carefully checked when opened.

When cash letters are very large, such as those coming from the larger banks in Philadelphia, it is customary to split the letter into two or more batches. As a matter of fact, a letter of this size will consist of two or more pages and the Federal reserve bank requires in such cases that there be inserted as well a recapitulation sheet, appropriately designated as such, on which is listed the totals of the checks listed on each sheet of the cash letter. It is customary, in making up the batches, to separate

the checks in accordance with the pages of the cash letter, that is to say, the checks called for by a particular page and that page of the letter are made up as one batch.

Should a cash letter be large enough to necessitate splitting it into two or more batches, the clerk who made up the batch would indicate the fact on the cash letter by noting the number of batches into which it has been divided. A figure enclosed in a circle is the method followed by the Philadelphia Federal Reserve Bank. When a split is made, a regular numbered batch sheet is used, but in addition, lettered batch sheets are used for the listing of items after they are sorted. For instance, if a cash letter received from the Fourth Street National Bank of Philadelphia, is divided into two batches, the checking clerk will, when making up the batches, mark the recap sheet of the original cash letter with a (2) and then will clip the recap sheet to the numbered batch sheet; in this instance, Pa. P—Z No. (whatever number happens to be next,) and hand it to the settlement clerk. He will then take an unnumbered blank batch sheet and mark it "A—Fourth Street National," enclose the checks chosen for the batch and that part of the cash letter which includes these checks, put a rubber band around the bundle and hand it over to the sorting clerk. The second batch is wrapped together with the other part of the letter and checks in a batch sheet and marked "B—Fourth Street National." These sheets are handled in the regular manner, but when they are completed the work on the A and B sheets is recapitulated by the settlement clerk on the numbered batch sheet. This recap shows the totals of each transit division on the two batch sheets, a grand total of the sheet, which must agree with the total of the cash letter, as sent in by the Fourth Street National Bank. Sheet A and B are then pinned to this recap sheet.

All completed batch sheets are turned over to the settlement clerk who carefully looks over the work to see whether the columns have been properly marked, and further to see whether the proper checks have been included in the proper column. The listing clerk may have run up checks belonging to two different divisions under one division, in which case they must be separated at this time. This checking is done by looking

at the first and last check in each division, and comparing the check with the listing on the batch sheet. After doing this the settlement clerk initials "settled by," detaches the batch sheets for use in making up the recapitulation and settlement sheets, and puts the bundles of checks in a rack which contains eleven compartments, one for each transit division, that is, Clearing House, Run, Philadelphia Reserve Bank, Delaware and New Jersey, etc. Thus all the incoming mail is listed on batch sheets and the checks belonging to each division are concentrated in this rack.

The organization of the transit department is so divided that certain men are confined to special divisions, namely, two clerks have charge of the Delaware and New Jersey Division (this division includes only that section of New Jersey which lies in District No. 3); two other clerks have charge of Pennsylvania A to D; three of Pennsylvania E to O; three of Pennsylvania P to Z; one "Other Philadelphia" and six of the "Reserve," which includes all checks drawn on cities outside of Federal reserve district No. 3. These divisions work independently of each other. All the clerks, however, before taking up the work of their sections make up the batch sheets as described above.

The Recapitulation Sheet.—All the batch sheets are assembled and a recapitulation made of the eleven divisions of these sheets. The totals of each division on the batch sheets is listed on the recap sheet. For example, the total of the Clearing House is taken off of each batch sheet and listed on the recap sheet, the total of this column is struck, the duplex machine transferring and carrying this amount in the lower counter; likewise, all batch sheet totals of the Run are listed on the recap sheet, a total taken, and automatically transferred to the lower counter of the machine and added to the Clearing House total. After all the transit divisions are recapitulated in this way, the grand total of all the divisions on the batch sheets, which has been accumulated in the lower counter, is printed on the recap sheet. The totals of all the cash letters are next recapitulated from the batch sheets on the recap sheet, a grand total taken, which total should agree with the grand divisional total. Thus, the recap sheet shows in total all the checks as distributed from the incoming mail to each division of the transit department.

However, there are certain items which do not come into the transit department through the mail. Government deposits, items from the receiving and paying tellers, interest checks from the discount department, and exchanges, which include checks lacking endorsements that have been returned by the city banks which received them in the city clearing from the reserve bank, all go through the transit department but are not handled in the mail. These items go through the regular channels to the transit department as previously described, that is, they are checked, batched, listed and racked with the other items. However, a separate batch sheet is made up for each, namely, government, paying teller, receiving teller, exchanges, discounts. These batch sheets are not merged into the recap sheet but the totals are transferred directly to the settlement sheet as hereafter described.

The Settlement Sheet—The settlement sheet contains a division for each of the eleven divisions of the transit department. The totals of the divisions on the recap sheet are transferred to the proper division on the settlement sheet. This represents the amount with which the transit sections are charged. In addition, however, the totals of the government, paying, receiving, discount, and exchange batch sheets are transferred to the proper divisions on the settlement sheet.

Since the completed settlement sheet then shows the aggregate amount of the checks which were given to each division in the transit department, it follows that the total of the outgoing letters of each division must agree with the amount charged to them on the settlement sheet. The items for the "Clearing House," "Run," and "Other Philadelphia" divisions have been checked and verified with the debits against these departments on the settlement sheet. The aggregate of the outgoing letters comprised in each of the divisions—such as Delaware and New Jersey, for example—must equal the aggregate charged to that division. Thus there is a check on the work of the entire transit department.

The Philadelphia Clearing House Items.—The checks for the Philadelphia Clearing House must be taken care of first, as the city clearing takes place at 10 A. M., and the rules of the association,

penalize the tardy members. To facilitate the work of this handle the clearing house items. Each morning the clearing section several men are taken from their regular divisions to house department has on hand checks received the preceding day, which arrived after the city clearing for that day. These checks are "racked down" or sorted into a rack containing a compartment for every member of the clearing house. A rack consists of a series of pigeon holes, large enough to accommodate the ordinary check, each clearing house member having a pigeon hole. The front of the rack is open, the back is covered with a wire net. The pigeon holes are approximately three inches wide, eight or nine inches deep, and of varying height. The racks are so constructed that the height of the pigeon holes or compartments can be adjusted. The average rack is about three feet high and is set on a table. The width is determined by the number of compartments necessary, and the ability of one or two men to work efficiently in sorting checks into the same rack.

After the sorting is completed and the work verified, the checks drawn on each member are listed separately in adding machine on a duplicate slip, the total being printed at the bottom, and the listing verified. A rubber band is placed around the checks and the original of the slip and the package is inserted in the clearing house envelope, addressed to the clearing house member in question, and at the same time, the total called for on the slip is written in ink on the outside of the envelope. The envelopes containing such checks are kept in a fireproof safe overnight.

The checks received in the morning mail are put through the electric endorsing machine and are then racked down. After the checks received in the morning's mail have been racked down, the checks for each bank are listed on an adding machine and the total thereof indicated. The adding machine tape is affixed to the checks with a rubber band and inserted in the envelope, referred to above, addressed to the member of the clearing house. The envelope is then handed to another clerk, who again lists and adds the morning checks on

an adding machine. This operation will prove whether the morning checks have been correctly listed and that the total is accurate. The second tape forms the transit department's record of the morning checks included in each package. Their record of the "hold-over" items herein included is the duplicate of the list which has been made out the preceding afternoon.

The clerk in charge of the city clearing department then lists the total of the morning work included in each envelope on the outside of the envelope, and adds to that figure the amount of the "hold-over" which already appears thereon. These figures are totaled and to prove the work of the department, the total of each envelope is listed. The grand total of all must agree with the total checks charged to this department, as shown by the clearing house division on the settlement sheet. After the work has been proven the envelopes are sealed and secured by sealing wax.

In the meantime the following lists are made up to be used at the clearing house. The clearing house requires that items on what are termed outside institutions be reported separately. These institutions maintain a limited membership in the clearing house, which entitles them to the clearing privilege only. These sheets and the envelopes for the clearing house members are now ready to be taken to the clearing house. The form of the sheet is as follows:

NO. 4

THE FEDERAL RESERVE BANK
ITEMS ON OUTSIDE INSTITUTIONS
RECEIPTS FOR PACKAGES,

1917

NO.	INSTITUTIONS	AMOUNT SENT	RECEIVED BY
101	ALDINE TRUST,		
102	AMERICAN BANK & TRUST,		
103	NATIONAL BANK OF COMMERCE,		
104	CAMDEN NAT. BANK,		
105	CAMDEN, FIRST NAT., STATE,		
107	CENTRAL TRUST,		
108	COLONIAL TRUST,		
110	COMMONWEALTH TITLE,		
111	CONTINENTAL-EQUITABLE T. & I.,		
113	FIDELITY TRUST,		
114	FRANKLIN TRUST,		
115	LIBERTY TITLE & TRUST,		
116	GUARANTEE TRUST,		
117	HADDINGTON TITLE,		
118	HAMILTON TRUST,		
119	INTEGRITY TRUST,		
121	MUTUAL TRUST,		
122	NORTHERN TRUST,		
123	NORTH PHILADELPHIA TRUST,		
124	NORTHWESTERN TRUST,		
125	PEOPLES BANK AND TRUST,		
127	REAL ESTATE TRUST,		

NO.	INSTITUTIONS	AMOUNT SENT	RECEIVED BY
128	REPUBLIC TRUST,		
131	UNITED SECURITY L. INS. & T.,		
132	WEST END TRUST,		
134	KENSINGTON TRUST,		
135			
136			
137			
138			
139			
140			
141			
142			
143			
144			

NO. 4

FROM FEDERAL RESERVE BANK

RECEIPTS FOR PACKAGES

CLERKS' PACKAGE STATEMENT,

1917

NO.	MEMBERS	AMOUNT SENT	RECEIVED BY
1	PHILADELPHIA,		
2	BK. NORTH AMERICA & TRUST,		
4	FEDERAL RESERVE,		
7	SOUTHWARK,		
8	KENSINGTON,		
9	PENN,		
13	GIRARD,		
14	TRADESMENS,		
18	CORN EXCHANGE,		
19	UNION,		
20	FIRST,		
21	THIRD,		
23	SIXTH,		
25	EIGHTH,		
26	CENTRAL,		
28	SECURITY,		
33	NINTH BANK & TRUST,		
34	TENTH,		
36	NORTHWESTERN,		
37	SOUTHWESTERN,		
39	FOURTH STREET,		
40	MARKET STREET,		

NO.	INSTITUTIONS	AMOUNT SENT	RECEIVED BY
42	QUAKER CITY,		
43	NORTHERN,		
44	FRANKLIN,		
45	TEXTILE,		
46	LAND TITLE & TRUST,		
47	REAL ESTATE TITLE,		
48	GIRARD TRUST,		
49	WEST PHILA. TITLE,		
50	PHILADELPHIA TRUST		
51	PROVIDENT TRUST,		
52	PENNSYLVANIA CO., CLEARING HOUSE		
	TOTAL,		

The clerks also take to the clearing house the following credit tickets, which are given to the clearing house manager who credits the bank on his clearing sheet with these amounts in the day's clearing:

NO. 4 191

THE FEDERAL RESERVE BANK OF PHILADELPHIA

TOTAL CREDITS

\$.....

NO. 4

191

**FEDERAL RESERVE BANK
TOTAL OF ITEMS ON
OUTSIDE INSTITUTIONS**

\$.....

The Federal reserve bank not only presents items against members of the clearing house, but also receives in the daily clearing drafts drawn against the accounts of its depositors presented by members of the clearing house. Members of the Federal Reserve Bank of Philadelphia may have drawn drafts against their balances in that bank and these drafts may ultimately have been deposited with members of the Philadelphia Clearing House, who present them through that organization to the Federal Reserve Bank. However, the Federal reserve bank usually deposits more items for credit in the clearing house than are presented to it in the clearing. This makes the Federal reserve bank a credit bank, and gives it the right to receive the difference between the credits and debits in clearing house gold certificates. Sometimes, however, the Federal reserve bank is a debtor and then it must pay the difference to the clearing house in gold certificates. It would seem that if the Federal reserve bank were a creditor in the clearing house most of the time, it would draw gold from the other city banks. However, this is not the case, for the city banks build up their deposits with the Federal reserve bank by means of out-of-town checks, and thus they create balances in excess of the actual reserve which the law requires them to keep. They draw drafts against these balances and receive from the Federal reserve bank eligible funds with which they pay their clearing house debit balances.

The Run and Other Philadelphia Items.—The "Run" items are next taken care of. These items are sorted in a rack which contains a compartment for every bank and banker in Philadelphia, not a member of the clearing house. A number of private bankers and a few commercial bankers comprise the list. The process of handling these items is exactly like that of handling the clearing house items, that is to say, the checks are listed, a copy kept of the list and then the checks are put into

envelopes addressed to the banks from which they are to be collected. The total of these envelopes must agree with the "Run" division on the settlement sheet before the run is dispatched. The "Run" is disposed of by 10.30 A. M.

Each runner is charged with the total amount included in the envelopes which constitute his route, and the total of the entire run is charged to the paying teller, to whom the runners report after they have finished their business. A run account in the general ledger is charged by the bookkeeper for the total of the run as shown by the transit department's record. This account is credited when the runners return with the proceeds from the items which they delivered to the several institutions, the paying teller being charged with the same amount, which he accounts for in his cash and cash items. The rules of the Federal reserve bank allow run items to be settled either with a check on a Philadelphia bank or in cash, so in case the paying teller receives Philadelphia items he will turn these over to the transit department, who will put them through the Philadelphia clearing house on the following day.

By 11.00 A. M. every check received which is payable in Philadelphia, has left the bank including items on outlying national banks and trust companies, known as "Other Philadelphia," which are listed, proved and mailed immediately so that they will be received by the drawee bank and remitted for the same day.

Sorting Out-Of-Town Checks.—The Philadelphia items having been settled, the clerks now proceed on the work of their assigned divisions. Each division takes the checks from the distributing rack, where they were placed after the batch sheets had been settled, and sorts them into its own racks. The rack—sometimes called a bin—contains a compartment for every bank in the respective division to which checks are sent for collection. To verify the sorting, the clerk takes the checks out of the first compartment, examines them to see whether they all bear the name of the bank designated on the compartment in the rack from which he took them, then puts them back and repeats the operation for every pigeon hole or compartment in the rack. It is necessary to do this because an experienced transit clerk

learns to know the position of each bank's compartment in the rack and in sorting, which is done very rapidly, he may have inadvertently put a check in the wrong compartment. This verification will disclose the error which is, of course, immediately corrected.

Preparing the Outgoing Letters.—The contents of each compartment or pigeon hole is now ready to be made up on an outgoing letter. These letters consist of a printed form made in duplicate, the second sheet of which is blank, but being attached to the first by a perforated edge. Previously, carbons have been inserted and sheets run through an addressograph so that there will appear under the printed head "Federal Reserve Bank of Philadelphia", the name of a particular bank (which will also appear on the carbon). These blank letters are arranged to follow the order of the rack, so they will come to hand as the process of listing progresses. The checks in the rack are now taken out and listed on the letter. The listing consists of listing the amount called for by each check contained in the compartment, the total being pulled at the bottom of the letter. A blank letter appears as follows:

FORM 28

FEDERAL RESERVE BANK
OF PHILADELPHIA
We enclose cash items as listed below

Wire Non-Payment of Items of \$500. and over: DO NOT PROTEST any Items of \$10. or under, or those stamped N. P. 3-4 or those with a similar stamp of a preceding endorser.

FRANK M. HARDT, *Cashier.*

With the exception of letters sent to other Federal reserve banks, checks are merely listed on the letters, no description accompanying the items, as it is comparatively easy to trace an item by the amount, and the extra labor in describing checks can not be justified. It must be remembered that thirty-five clerks handle 48,000 items in a day. The total of each cash

letter listed is transferred to and carried in the lower counter of the duplex adding machine, so that after all the letters have been made up, the aggregate totals of the lower counter of the machines in a transit division must agree with the total checks charged to the division by the settlement clerk on the settlement sheet. If the totals do not agree each clerk checks back his work immediately in order to locate the difference. A search must be continued until the error is found, unless the error is less than a dollar which can be carried in the "difference account". In effecting the divisional settlement the following form is used:

DETAILED SETTLEMENT OF THE.....SECTION	
Struck Settlement at.....o'clock
	over
Original difference.....	short
	over
Final Settlement.....short
Time.....	

Upon the completion of this work the report is filed with the manager of the transit department.

The foregoing description covers the work of six divisions or sections, viz.: "Delaware and New Jersey"; "Pennsylvania A to D"; "Pennsylvania E to O"; "Pennsylvania P to Z"; "Eastern" (meaning New York and New England) and "other reserve districts." By dividing the work into sections, two positive advantages are secured, first, the well-known advantage, utilized wherever possible in all accounting systems, of creating groups of accounts, thereby localizing errors and simplifying and expediting the work of locating such as occur. The second advantage is that by limiting the number of institutions handled by one clerk or group of clerks, greater familiarity with the work can be secured, expediting its performance and decreasing the likelihood of error.

Presuming that a section has been able to settle, the outgoing letters are laid aside to await the afternoon mail, which is handled in exactly the same manner as the morning mail. Upon completion of the afternoon sorting the same outgoing cash letters

are put in the adding machines. The total of the morning mail, as called for on the letter, is inserted in the machine (but not again printed on the letter) and the listing of the individual checks follows. Upon completion of the listing a grand total of the letter is struck and also transferred and carried in the lower counter of the adding machine as in the morning. The aggregate of the grand totals in the machines of the division must agree with the amount charged to the division on the settlement sheet. When the settlement has been effected the outgoing letters are ready for mailing. The checks and the first page of the letter are placed in an addressed envelope and sealed. The duplicates are handed to the manager of the transit department, who transmits them in due course to the bookkeepers in the bank who use them as the basis for charges to the accounts of the several banks to which the checks were sent for collection.

Collection of Checks on Non-Member State Banks.—Included among the institutions comprised in each section, such as, for example, "Delaware and New Jersey" or "Pennsylvania A to D," are many state institutions which, while not members of the Federal reserve system, have nevertheless agreed to remit at par for checks drawn on themselves and sent to them for collection by the Federal reserve bank. A pigeon hole is provided in the rack for each non-member institution just as though it were a member bank.

Checks on non-member state banks may be collected in several ways. First an agreement is made between the Federal reserve bank and the state institution that items drawn on the state bank will be forwarded directly by the Federal reserve bank and that the state bank will immediately remit by draft on its Philadelphia or New York correspondent (preferably Philadelphia) or ship currency at the expense of the Federal reserve bank. A second method is for the Federal reserve bank to forward items to one or more member banks in the same city, which have previously agreed to put them through the local clearing house or have them collected by runners. Where this arrangement prevails the Federal reserve bank handles the items as if drawn on the member bank to which they are forwarded. The officials of the Federal reserve bank personally make these

arrangements and succeed in doing so by explaining the advantage of par collections. This puts the state bank checks on the same basis as checks drawn on national banks. Where the state banks have agreed to the conditions no further trouble has arisen.

In Federal reserve districts Nos. 1, 2 and 12,—in other words, the territory allotted to the Federal reserve banks of Boston, New York and San Francisco respectively,—the reserve banks accept checks for credit and collection drawn on any bank in the district, regardless of whether the bank has agreed or refused to remit for such checks at par. Wherever the non-member bank has agreed to remit at par, the checks are handled in the ordinary manner heretofore described. Checks drawn on institutions in these districts, which have not agreed to remit at par are collected through member banks located in the same town, which have agreed to assume this work, or through the express companies.

Criticism has arisen in some quarters concerning the practice of the Federal reserve banks accepting checks for collection on non-member banks which have agreed to remit at par. Objection is made on the ground that while member banks are required to keep a deposit with the Federal reserve bank which, to a degree, safeguards the payment of checks in the process of collection, yet in the case of non-member institutions, there is no such balance and consequently no safeguard of this character. It is further contended that this opens up a valuable facility to a non-member institution which it can enjoy without in any way supporting the Federal reserve system. As opposed to the foregoing contentions it is pointed out that the Federal reserve bank merely acts as the agent for the remitting member bank and that anything which increases the ease of collecting checks to a member bank is of advantage to it and to all member banks in the system. The further argument is advanced that many state banks are so small that a radical reorganization will be necessary to enable them to meet the minimum capital requirements of the Federal Reserve Act.

Among the amendments which were introduced in Congress at the suggestion of the Federal Reserve Board in January, 1917,

and which were reintroduced shortly after the opening of the "war session" in April of the same year, was one proposing a revision of that part of Section 13 dealing with the matter of clearings and collections. The changes proposed were, first, the addition of a phrase enabling a Federal reserve bank to handle for collection maturing notes and bills, payable within its district. In addition, the following clauses are added: "or solely for the purposes of exchange or of collection, a Federal reserve bank may receive from any non-member bank or trust company deposits of current funds in lawful money, national-bank notes, Federal reserve notes, checks and drafts payable upon presentation, or maturing notes and bills: Provided, Such non-member bank or trust company maintains with the Federal reserve bank of its district a balance in an amount to be determined by the Federal Reserve Board under such rules and regulations as it may prescribe."

In explanation of the action of the Board in recommending the foregoing above amendment, the following statement appears in the Federal Reserve Bulletin for March 1917.

"It is contemplated that the compensating balances which non-member banks participating in the clearing plan will be required to keep with Federal Reserve Banks will be sufficiently large to protect member banks and justify Federal Reserve Banks in undertaking the service. Any clearing and collection plan to be effective must be so comprehensive as to include all checks. At present the par lists of the Federal Reserve Banks include the names of banks checks on which can be collected in any circumstances at a minimum of time and expense, but do not embrace a large number of towns in every State where there are no member banks; and in order to make collections on such points many banks are obliged to maintain accounts in addition to their reserve accounts with the Federal Reserve Banks. A necessary factor in any successful clearing plan is the offset whereby balances only require settlement instead of the total volume of transactions. As long as the clearing system does not embrace all of banks, this offset is lost in a corresponding degree and the value of the system diminished in proportion."

It should be emphasized that if the foregoing amendment is enacted into law, which seems likely in view of its endorsement by the administration, it will be possible for non-member

banks to secure reciprocal advantages from the Federal reserve collection system; that is to say, to have their checks pass at par throughout the district and furthermore, to be able themselves to use the Federal reserve banks for the collection of out-of-town checks which they have received from their depositors. It should be kept in mind that this arrangement does not in itself confer membership upon state banks, and will not allow them the privilege of rediscount or other protection afforded to full members of the Federal reserve system. The arrangement is made for the convenience of the public and incidentally for the benefit of the member banks.

"Eastern," "Other Reserve Districts" and "Divisions."—As previously explained all checks sent to the Federal Reserve Bank of Philadelphia for deposit and collection and drawn on institutions situated outside of the Federal reserve district No. 3 are classified into two divisions—"Eastern" comprising Federal Reserve Districts No. 1 and No. 2, consisting of New England, the state of New York, and the northern portion of New Jersey—and "Other Reserve Districts" which includes the entire country, with the exception of Federal Reserve Districts, No. 1, 2 and 3.

Checks on banks included in the eastern division are resorted according to whether the member bank is situated in the territory of the Boston Federal Reserve Bank or the New York Federal Reserve Bank, the pigeon holes being respectively denominated "The Boston Federal Reserve Bank" and "The New York Federal Reserve Bank." After this separation has been accomplished, the checks for each reserve bank are further sub-divided according to the period of time which must elapse under the time schedule, before the credit therefor will be available. For example, checks of the New York Federal reserve bank are sub-divided into two groups—first, those drawn on the Federal Reserve Bank of New York, or upon other banks situated in New York City; second, those drawn upon banks situated outside of New York City.

The arrangement now prevailing in the Philadelphia District, is, in substance, that checks remitted by banks situated outside of Philadelphia to the Federal reserve bank for credit and collection, drawn upon banks situated in New York City, will be

entitled to immediate credit. When such checks are remitted, however, by banks situated in Philadelphia, credit will be given one day after receipt. This practice follows in the main the custom inaugurated by the country collection department of the Boston Clearing House prior to the creation of the Federal reserve system. It permits the country banks to remit for checks sent to them for collection by their Federal reserve bank either in New York or Philadelphia exchange. It is in reality a concession designed to increase the attractiveness of the collection system to country banks. Checks drawn on banks situated in New England are classified into two groups; those payable in Boston, for which credit is given one business day after receipt; and those drawn on banks in any other part of New England, for which credit is available to the depositing member bank two business days after receipt by the Philadelphia Federal Reserve Bank.

All checks drawn on banks situated in the New York Federal Reserve District are sent by the Federal Reserve Bank of Philadelphia to its sister institution in New York for credit and collection. A similar course of action is followed with checks drawn on banks situated in the Boston district, also with checks drawn on banks situated in any other Federal reserve district. This is the fundamental principle underlying inter-drawn on banks situated in any other Federal reserve district collections. Through the use of such a system the collection machinery of any particular Federal reserve bank is much simplified. Any Federal reserve bank is confined in its activities to dealings with its member banks; with non-member state banks situated within its district, which have agreed to remit at par; with the clearing house of the city in which the reserve bank is situated, and with each of the other eleven Federal reserve banks. The eleven accounts with the other Federal reserve banks may be likened to great trunk lines over which collections can be made with thousands of other banks situated throughout the United States, without any duplication of machinery or confusion of work.

Because of the differences in the time at which the proceeds of checks drawn on banks situated in different parts of the Federal reserve districts are available, two outgoing letters are used in

sending checks for collection to each reserve bank. The first accompanies city items, that is checks drawn on banks situated in the same city as the reserve bank; the second accompanying country items or checks drawn on banks situated in any other part of the reserve district. Each item is described as it is listed by using the universal numerical system symbol or by inserting the name of the bank. The form of these letters are as follows:

FORM 55 25M

**FEDERAL RESERVE BANK
OF PHILADELPHIA**

3-4

City Items

3-4

INSTRUCTIONS

{ TELEGRAPH NON-PAYMENTS OF ITEMS \$500 OR OVER.
PROTEST ALL ITEMS OVER \$10 EXCEPT THOSE BEARING
ON THEIR FACE THIS STAMP (N. P. 3-4) OR A SIMILAR
STAMP CONTAINING THE TRANSIT NUMBER OF A
PRECEDING BANK ENDORSER.

FORM 56 75M

**FEDERAL RESERVE BANK
OF PHILADELPHIA**

3-4

Country Items

3-4

INSTRUCTIONS

{ TELEGRAPH NON-PAYMENTS OF ITEMS \$500 OR OVER.
PROTEST ALL ITEMS OVER \$10 EXCEPT THOSE BEARING
ON THEIR FACE THIS STAMP (N. P. 3-4) OR A SIMILAR
STAMP CONTAINING THE TRANSIT NUMBER OF A
PRECEDING BANK ENDORSER.

Report By the Transit Department to the Bookkeeping Department.—Viewed in its largest aspect, the primary function of the transit department of a bank is to convert into cash checks and other credit items passing through its hands. The results of the work of the transit department are shown by the creation of credits and debits to the accounts of the bank's depositors. It is not the purpose of this study to follow in detail the bookkeeping system of the Federal reserve bank, but it is necessary, however, to indicate the manner in which the transit department reports to the bookkeeping department the results of its operation, furnishing the basis for the entries to the several accounts of the member banks and of the other institutions that are depositors with the Federal reserve bank. After the batch sheets have been settled, the incoming cash letters are sent by the transit department to the bookkeeping department where the total of each letter is credited to the account of the depositing bank. After the total has been posted, the letters are acknowledged, use being made of the following form:

FEDERAL RESERVE BANK OF PHILADELPHIA

Date.....

We credit your account

.....
Your favor of the.....instant
has been received with enclosures as
stated.

F-29

F. M. HARDT, *Cashier.*

Charges against the accounts of member banks, as has been said, are made from the duplicates of the outgoing cash letters, which are sent by the manager of the transit department to the

bookkeeping department after the work of the former department has been completed and proved. On the second day after the checks have been forwarded or, in other words, two days after the date of the outgoing cash letter, the bookkeepers will charge the proper accounts with the amount of the outgoing letters. In the interim, the duplicate letters are held separately. After the proper entries have been made, the duplicate letters are returned to the transit department for permanent file.

In case the remittance of the bank is in the form of cash, the package does not go to the transit department but directly to the receiving teller, who acknowledges its receipt by properly filling out and mailing the following acknowledgement letter:

FORM 33**FEDERAL RESERVE BANK OF PHILADELPHIA**

..... Date.....

We beg to acknowledge receipt of your
(Shipment of Cash) and credit, subject to

count..... \$.....

Deposit through No. \$.....

..... Teller.

F. M. HARDT, Cashier.

General Summary.—The operations of the Federal reserve transit department may be summarized as follows:

First: The incoming mail is sorted into five divisions depending upon point of origin, i. e.

- (1) Delaware and New Jersey, Pennsylvania A-D.
- (2) Pennsylvania E-O.
- (3) Pennsylvania P-Z.
- (4) Other reserve banks.
- (5) Non-member state banks.

Second: The mail is opened and checked.

Third: The contents of a package or packages are batched and then sorted into eleven transit divisions.

- (1) Clearing House Item.
- (2) Run.
- (3) Federal Reserve Bank of Philadelphia.
- (4) Return items.
- (5) Delaware and New Jersey.
- (6) Pennsylvania A-D.
- (7) Pennsylvania E-O.
- (8) Pennsylvania P-Z.
- (9) Other Philadelphia.
- (10) Eastern (New York and New England).
- (11) Other reserve districts.

Fourth: Items are listed under proper headings on a numbered batch sheet.

Fifth: Make-up of each batch sheet is examined by the settling clerk.

Sixth: The batch sheets are kept by the settlement clerk, who after assembling all of them makes up a recap sheet.

Seventh: A settlement sheet is made up from the recap sheet and additional data received from the tellers in the Federal reserve bank is also included.

Eighth: The checks are assembled and then taken to the proper divisions where they are racked.

Ninth: Outgoing letters addressed to the banks on which checks are drawn, are made up.

Tenth: Each division settles by proving that outgoing letter totals equal the incoming items as shown by the settlement sheet.

Eleventh: Checks with letters are put in envelopes, sealed, stamped and mailed.

Twelfth: The incoming letters are acknowledged; then posted to the proper accounts by the bookkeepers, and returned to the transit department for permanent records.

Variations in Transit Methods of the Federal Reserve Banks.—Although the plan of the Philadelphia Reserve Bank is typical, it varies in some details from the methods employed in other districts. The Federal Reserve Bank of Boston requires that the depositing bank arrange its cash letter not only to conform to the time schedule, as was explained in the description of the

Philadelphia Bank, but in addition that all checks drawn on the same bank be grouped and handled as one amount. That is, if several checks on the same institution are included in a letter, a rubber band is put around them and a list of these checks and the total thereof is included. This saves the transit department a great deal of work, for it does not have to sort each check in the deposit, but handles them in groups. This facilitates the work in handling large deposits, particularly those of the Boston banks, because in these deposits are included many items which are drawn on the same bank in the district. In levying the service charge against the depositing banks, the Federal Reserve Bank of Boston assesses the depositing bank nine-tenths of one cent for each individual check enclosed. It does not base the charge upon the number of groups enclosed.

The old Boston clearing house plan differs from the Boston reserve bank's plan in that the latter is reciprocal. Under the old system New England country banks were largely compelled to use the Boston banks in the collection of checks drawn on other New England banks, because in no other way cou'd the remarkably efficient and economical service of the country collection department of the Boston Clearing House be enjoyed. This tremendously emphasized the importance and value of the Boston banks as reserve agents. Now the country banks can secure the same service through the Federal reserve bank without dealing with the Boston city banks. The latter are still used because of inertia, or because the country bank can thereby avoid paying the service charge itself—saddling this expense upon the Boston city bank, which in turn is reimbursed out of the profits which it makes on the country bank's balance. At present the country bank is not allowed to carry more than one-sixth of its required reserve of 12 per cent on deposit with the Boston banks. This 2 per cent reserve, if carried in the Federal reserve bank in addition to the 5 per cent which must at this time be there carried on deposit would earn nothing for the country bank. If carried with the old reserve agent it earns 2 per cent interest per annum for the country bank, and in many cases enables the latter to avoid paying directly the collection charges. Thus it follows that the country

bank's deposit in the Boston bank serves a double purpose and in Boston as elsewhere, the larger part of the collection items continue to come to the Federal reserve bank through the city banks.

After November 1917, at the latest, the country banks will be faced with the alternative of continuing to carry a balance with their former reserve agents for the sole purpose of avoiding the direct payment of the service charge and in return for such advice and other service as the old reserve agents have heretofore performed for them. Such balances cannot thereafter be counted as a part of the country bank's legal reserve. It seems self-evident that the city bank will not assume service charges and other expenses in a greater amount than it can earn from the use of the country bank's balance. Many country bankers may prefer to pay their service charges indirectly through the maintenance of a compensating balance, but in spite of the well known preference of all men for indirect taxation or charges and of the equally well known conservatism and unwillingness of the banker to make changes, it appears likely that with the passage of the old system of reserve agents there will be a decrease in the volume of checks which will go through the Boston banks. In consequence it will probably be necessary to a constantly increasing degree, for the Federal Reserve Bank of Boston to handle more individual items.

The plan followed by the Dallas bank differs from the others, for while deposits of items are credited immediately, the funds are not available until the remittances have actually been received. No time schedule is followed, but when remittances are received by the reserve bank, the credits established by the corresponding deposit of the bank which sent in the items are released for use. Under this arrangement the depositing bank does not know definitely when its credits will be available.

The Gold Settlement Fund.—Section 16 of the Federal Reserve Act directs the Federal Reserve Board to formulate regulations governing the transfer of funds and charges therefor among the Federal reserve banks and their branches. It further gives to the Board the discretionary right to "exercise the functions of a clearing house for such Federal reserve banks." Acting under

this authority, the Federal Reserve Board by Regulation I, issued in June 1915, established the "Gold Settlement Fund." Each Federal reserve bank was required to deposit for credit to the account of the Gold Settlement Fund \$1,000,000 in gold, gold certificates or gold order certificates and in addition an amount at least equal to its net indebtedness due to all the Federal reserve banks at that time. The regulation further provided that each Federal reserve bank should always maintain a balance in the fund of not less than \$1,000,000. However, excess balances may, at the convenience of each Federal reserve bank, remain on deposit in the fund, and as the balance on deposit in the Gold Settlement Fund may be counted as part of the Federal reserve bank's reserve there is no object in keeping only the minimum on deposit. The Treasury Department has provided the Reserve Board with a safe in one of the Treasury vaults to accommodate these deposits of gold and certificates. The combination of this safe is controlled by two persons representing the Board although two persons designated by the Secretary of the Treasury must be present each time the safe is opened.

Each Federal reserve bank maintains on its books an account with every other Federal reserve bank. To these accounts items sent to the other Federal reserve banks for collection are charged or debited, as also are the payments and transfers of moneys which have been made for the accounts of each of the other Federal reserve banks. Each account is credited with the proceeds of items that have been received from the other reserve banks after they have been actually collected, and also for payments and transfers of funds which have been made to it for the account of each of the other Federal reserve banks. In addition, the Federal reserve bank carries on its books an account entitled "Gold Settlement Fund" to which is charged the amounts placed to the credit of the bank upon the books of the "Gold Settlement Fund" and maintained on the books of the Federal Reserve Board in Washington, and to which is credited all payments made through the Gold Settlement Fund, either through the weekly settlement or by mail or telegraphic transfers.

At the close of business on Wednesday afternoon, the Federal

reserve banks telegraph to the Federal Reserve Board the amounts in even thousands of dollars "due to" or the total credits in the account of each of the other Federal reserve banks at that time. The total debits are not reported nor is the net balance of the account reported. The "due to" items reported by the other Federal reserve banks will act as the debits, when reported to the Board after the settlement. Should Wednesday be a holiday the telegram is dispatched on Tuesday. All telegrams are confirmed by a mailed report.

On Thursday morning the Federal Reserve Board assembles the figures on a sheet known as "the checker board," which has the names of the Federal reserve banks at the head of twelve columns, and also at the left-hand margin. The form of "the checker board" is shown on page 55.

The amounts reported "due to" other Federal reserve banks are listed in the proper columns, under the names of the other banks to which the amounts are due; the total "due to" is entered at the right margin. Thus each horizontal column shows the amounts which the Federal reserve bank named in the left hand column owes to each other Federal reserve bank listed at the head of the vertical columns, and also the aggregate due to all other Federal reserve banks as entered on the right-hand margin. When the contents of all the telegrams have been entered and the columns of the "checker board" totaled both horizontally and vertically, each vertical column shows the amounts due to the bank listed at the head of the column from each of the other eleven Federal reserve banks, and the aggregate due to the bank is shown by the total of the vertical column. In other words the vertical column shows the aggregate amount "due from" the other banks to the bank listed at the head of the column. The Reserve Board then charges each bank's account with the total of the horizontal column opposite its name, and credits each bank's account with the total due it from other Federal reserve banks as shown by the total of the vertical column bearing the name of that bank.

The Board telegraphs to each reserve bank, confirming the telegram by mail, giving the "due to" amounts which other Federal reserve banks reported, that is to say, the details of the

vertical columns, and also the net amount which the particular bank is debtor or creditor in the weekly settlement of clearings. This is determined by ascertaining the difference between totals "due to" and "due from" as shown by the checkerboard. The instructions of the Federal Reserve Board are that "Each bank will then debit the '*Due to*' Federal reserve bank's accounts and credit the settlement fund, and will credit the '*due from*' Federal reserve banks' accounts and charge the Settlement Fund."

As previously stated figures are reported in even thousands so inter-bank accounts are not entirely settled each week. Also only the credits or amounts "due to" other Federal reserve banks are reported by each bank to the Board, which renders a weekly settlement of accounts impossible. The reserve banks reconcile their accounts monthly. In these reconcilements items in transit, and miscellaneous items can be readily checked up and accounted for.

Up to this point only that portion of the activities of the Gold Settlement Fund which relate to the periodical settlement of balances between the several Federal reserve banks arising out of collection operations has been considered. The Fund serves a second very important purpose. Through it, the Federal reserve banks are enabled to effect the transfer by telegraph of money from one to the other. The process, in brief, consists of a telegraphic order, in code, directed by one Federal reserve bank to the Federal Reserve Board authorizing the latter to credit a specified amount to the account of a designated Federal reserve bank. Upon the receipt of such a telegram, the Board will wire to the Federal reserve bank to which the transfer is to be made that it has placed the specified amount to the credit of that institution. At the same time, the Board will, by appropriate entries, debit the account of the one bank and credit that of the second. To all practical intents and purposes, the money, which in reality is gold, is just as useful to the second Federal reserve bank in the Gold Settlement Fund as it would be in its own vaults at its home office for the regulations allow the Federal reserve bank to count balances in the Gold Settlement Fund.

as a part of its reserve or to use such balances as the basis of note issue.*

The tremendous value of the Gold Settlement Fund to the reserve banks has been evident from the outset. It has operated with remarkable economy and efficiency. The results of the first year of operation were well described by the Board in the Federal Reserve Bulletin for June, 1916:

"Since the gold-settlement fund has now been in operation for one year, it may be interesting to review briefly the more important features of its operations. The primary object for which the fund was established was the settlement of obligations arising from the 12 Federal Reserve Banks, and the extent of its operations of this kind may be measured by the total amount of weekly clearings and transfers. These have amounted since May 20, 1915, to \$2,178,240,000, almost half of this amount having been handled since the beginning of the present year. The weekly settlements and transfers which at first averaged approximately \$20,000,000, have steadily increased. For each of the last four weeks they exceeded \$60,000,000 and for the week ending May 25 were close to \$80,000,000. It is expected that with the more active clearing operations by Federal Reserve Banks, which are to begin July 15, the amounts settled each week will in all probability be considerably increased.

"The most important function of the fund has been to obviate unnecessary shipments of gold currency between the various sections of the country. The first step in such a process is, of course, to offset and cancel by clearing as many obligations and of as large amount as possible, and this the Federal Reserve Banks have accomplished and will to a still greater degree accomplish through the gold settlement fund. The result of the clearing process thus far has been that for \$2,178,240,000 of obligations settled, there has remained only a net balance of \$144,288,000, or 6.62 per cent, to be paid by transfer of ownership of the gold certificates held. Not only has the net amount necessary to be covered by payment of gold or its equivalent been minimized by the clearing operation of the fund, but the actual shipment of even the relatively small balance has been entirely avoided. With the aid and co-operation of the Treasury Department, it has been possible to have any Federal Reserve Bank becoming debtor to another bank merely make deposit with the nearest

* Mention should be made in passing of the fact that in addition to the Gold Settlement Fund operations above described, the Federal Reserve Board has created a Gold Settlement Fund for Federal reserve agents, which is used in connection with the operations of issuing, securing and retiring Federal reserve notes. This latter fund has no direct connection with the subject matter of this study.

sub-treasury (six Federal Reserve cities have sub-treasuries), and gold certificates have been issued at Washington payable to the order of the Federal Reserve Board, to be held in the gold settlement fund. On the other hand, whenever a Federal Bank has need of funds to its credit, the operation has been reversed and payment made by the nearest sub-treasury. Such withdrawals have been relatively small in volume and the major portion of the gold paid into the fund has been permitted to remain.

Under the abnormal conditions prevalent during the past year, seasonal movements of currency in the United States have been much deranged and the usual ebb and flow has not taken place. Large imports of gold have reached New York City, very substantial portions of which had as their ultimate destination the various industrial and agricultural centers, from which had gone the exports of commodities. Through this movement and through the call on New York City banks for funds to make payments due from member banks throughout the country on account of installments of reserve deposits with the Federal Reserve Banks, a condition was created which, without the gold settlement fund, would undoubtedly have occasioned large and expensive domestic gold shipments from New York. Through the operation of the gold settlement fund the same end has been accomplished at almost negligible expense by the Federal Reserve Bank of New York depositing gold with the Sub-treasury for credit in the gold settlement fund and transferring the credit thus acquired to other Federal Reserve Banks. During the year almost \$126,000,000 has in this way been transferred from New York to other centers.

"An important service rendered to Federal Reserve Banks, and through them to member banks, has been the making of deposits with the Treasurer of the United States for various purposes, particularly for the release and transfer to Federal Reserve Banks of United States bonds securing national bank-note circulation."

In its annual report for the year 1916, the Federal Reserve Board presents additional data concerning the operations of the Gold Settlement Fund. The total volume of business cleared during the year 1916 was stated to have been about \$5,533,966,-000, handled at a cost of \$1,343.37, "being a net cost of \$.0002½ per \$1,000 . . . The net amount of change of ownership among the Federal reserve banks of gold held in the Fund was \$223,870,000, and it may be estimated conservatively that the shipment of coin and currency to at least this amount was thus avoided. . . The resulting change in ownership of gold was

4.0453 per cent of the total obligations settled, as compared with 8.14 per cent in 1915. There has been a rapid and steady growth in the volume of transactions handled through the Gold Settlement Fund. Especially has this been true since July 15, 1916, when the Federal reserve banks began active check clearing and collecting operations." Commenting further upon the results of operations of the Gold Settlement Fund from the date of its establishment to the close of the year 1916, the Federal Reserve Board stated:

The expectation that the operations of the fund would make unnecessary, for the most part, actual shipments of gold between Federal Reserve Banks, has been well justified by experience extending over 19 months. No expense for shipment of gold in connection with the fund's operations has been incurred other than the charges on a small number of shipments made by banks not located in cities having sub-treasuries. The abnormal inflow of gold from Europe entering the country at New York, though destined in large part for interior points whose exports had induced the gold movement, has influenced materially the trend of the settlements. The Federal Reserve Bank of New York has usually been debtor at the clearings and has parted with gold during the year to the amount of \$222,147,000, and since May 20, 1915, to the amount of \$303,430,000. This movement has resulted in increased reserves held by other Federal Reserve Banks and in increased holdings by Federal Reserve Agents against Federal Reserve notes outstanding.

The aggregate deposits of the twelve Federal reserve banks in the Gold Settlement Fund on May 4, 1917, were \$218,910,000; in addition to which \$153,570,000 was on deposit in the Federal Reserve Agents' Fund, making an aggregate of \$372,480,000 in the hands of the Federal Reserve Board.

Protest of State Banks Against Par Collections.—So long as the collection activities of the Federal reserve banks were upon a voluntary basis no considerable protest was voiced by the state banks. There is no doubt that a large number of the state banks were influenced against joining the reserve system by the profits derived from charging exchange upon checks drawn on themselves. Profits from this source continued so long as the banks remained non-members, and this was of great moment in a large number of cases.

The state banks' case against compulsory par collections has been vigorously and fully presented. Beginning with the resolution of protest by the Bankers' Association of Texas, determined efforts have been made to secure official condemnation of par collections by various bankers' associations. A meeting of some 150 accredited delegates, nominally representing twenty state bankers' associations, was held in St. Louis in June 1916. It was, as has been aptly phrased by a sympathetic state banker, "a convention of protest and not of deliberation, for it refused to listen to Festus J. Wade and others, who undertook to argue that there were some merits in the plan." The convention adopted resolutions declaring the plan to be "unwise, unnecessary, economically unsound and in the last analysis prejudicial to the best interest of general business." Unsuccessful efforts were made to secure the passage of a resolution by the Michigan Bankers' Association condemning par collections. On the other hand the Washington State Bankers' Association by resolution, adopted June 1916, declared that the plan for par check collections "is an unnecessary interference with the usual methods of banking" and "it is usurping one of the necessary functions of the member banks." The Virginia Bankers' Association, by resolution adopted June 24, 1916, declared that compulsory par check collections were "unwise and unnecessary features of the reserve act."

An effort was made without success to induce the American Bankers' Association to undertake or co-operate in legal proceedings attacking the constitutionality of Sections 13 and 16 of the Federal Reserve Act. The state bank members of the American Bankers' Association, however, organized a state bank section of that organization. Movements to organize state bankers into separate groups were publicly deprecated by the Federal Reserve Board.

The American Bankers' Association at its Convention, held in October, 1916, adopted a resolution which set forth in the preamble, among other things, that "the so-called par collection of checks is not a feature necessary to the attainment of the object sought by the Federal Reserve Act, and the system of collecting checks now in operation under the law, as interpreted

and applied by the Federal Reserve Board, works serious hardships upon and leavy losses to thousands of country banks, and

"WHEREAS, it is the belief of the majority of bankers that Congress did not intend to deprive the banks of legitimate profit, therefore

"*Be it Resolved*, That the American Bankers' Association, while approving the fundamental principles of the Federal Reserve Act and expressing loyalty to the Federal Reserve System, protest against the provisions of the Act relating to the collection of checks, and instructs the Committee on Federal Legislation of the American Bankers' Association to endeavor to secure amendments to the Federal Reserve Act, providing for the establishment of a collection system which is fair and equitable to all Banks and to the general public.

"*Be it Further Resolved*, That the President of the American Bankers' Association be authorized and directed to appoint a Committee of twenty-five bankers, fifteen of whom shall be country bankers, and ten of whom shall be reserve city bankers, and that this Committee co-operate with the Committee on Federal Legislation of the American Bankers' Association in bringing about the enactment of the desired amendment."

The majority of the Committee of Twenty-Five, as this body has come to be known, is composed of country bankers, who obviously have a special cause to plead. The framers of the resolution were evidently taking no chances with the nature of the Committee which the President of the Association, himself a banker, might appoint. The first meeting of the Committee of Twenty-Five was held in December, 1916. According to the report of the meeting, as prepared by Mr. Jerome Thralls, its Secretary:

"the Committee, after mature deliberation unanimously concluded, that its plain duty at this juncture is to seek an amendment to the law which will accord to banks the rights that are guaranteed by the Constitution of the United States to every citizen, (individual, firm and corporation) that is, the right to demand and receive fair compensation for services rendered entailing labor, risk and expense; and to undertake to bring about such modifications and changes in the Federal reserve clearing and collection system as are necessary to put it upon a basis where its development and extension will depend entirely upon merit. It was the consensus of opinion

that the Federal reserve clearing and collection system, like any private business of similar character, will succeed and endure only because of its ability to render the most efficient service upon the most economical lines, and that so far as possible, all features of compulsion and coercion should be removed. It was further expressed as the sense of the meeting that the country clearinghouses being operated in eleven of the leading centers of this country are most valuable and efficient collection agencies, and that such organizations should be established and maintained in all of the larger cities and that some plan should be evolved whereby they might be united in a national association through which cash items could be collected or cleared on every section of the United States. . . . It is not only the desire of every banker that the most modern, efficient, and economical methods for handling cash items be evolved and developed, but it is the duty of every banker to use his best efforts to that end, and to give the business public the benefits of such savings as may be effected through improved methods."

The prepared report of the deliberations further stated:

"The Committee has to deal with the problem of evolving the most efficient and economic means of handling annually over 723,763,570 so-called country checks, aggregating more than \$30,000,000,000, and on which an exchange charge of 66 2-3 cents per thousand dollars, or an annual amount of \$20,000,000, was assessed prior to July 15, 1916, and on which there was an expense in the handling (generally known as administrative cost) of 33 1-3 cents per thousand dollars, totalling annually \$10,000,000.

"The handling of these items affects the relations of, and the business of, 7,618 member banks and 20,799 state banks, bankers and trust companies, and the influence of changes in the vital principles relating to their issue, payment or handling permeates every line of business."

The amendment proposed by the "Committee of Twenty-Five" is designed to strike out paragraph 13 of section 16 of the Act and to reenact it with the addition of the following clause:

"Nothing herein contained shall be construed as prohibiting a member bank from making reasonable charges against the presenter, in no case to exceed 10 cents per hundred dollars or fraction thereof, based on the total

of checks and drafts presented at any one time, for collections or payments of checks and drafts drawn upon it and remission therefor by exchange or otherwise, or for exchange sold to its patrons. The Federal Reserve Board shall, by rule, fix the charge which may be imposed for the service of clearing or collection rendered by the Federal Reserve bank."

It will be observed that the Committee's amendment restricted the power of the Federal Reserve Board to fix and determine exchange charges to the charges made by the Federal reserve banks. It authorizes *every* bank to make a charge of ten cents for every \$100 or fraction thereof, irrespective of whether this charge is a reasonable charge for the cost of the service rendered by the institution.

The House of Representatives, before the close of the session of Congress terminating March 4, 1917, voted down the so-called Kitchen amendment, designed to accomplish the same effect as that proposed by the Committee of Twenty-Five. Bills to achieve the same end were introduced by Representatives Kitchen and McFadden in the House of Representatives shortly after the beginning of the "War Session" in April, 1917. Senator Gronna introduced in the Senate the amendment, proposed by the Committee of Twenty-Five, permitting an exchange charge, not exceeding ten cents per \$100 or fraction thereof. The Chairman of the Senate Committee on Banking and Currency referred the Gronna amendment to the Federal Reserve Board, with the request that the opinion of the Board concerning the advisability of its enactment be communicated to him. Governor Harding in his reply stated that

"After a full discussion of the matter the board directed me to say to you that it would regard the adoption of the amendment as most unfortunate. It believes firmly that it is the duty of every bank to pay without deduction or discount, at its own counter, checks drawn by its depositors against their balances. No bank questions this obligation on its part when cash payments are demanded by the presenter of the check, and about one-half of all banking institutions in the country are now remitting without deduction for checks on themselves forwarded by the Federal Reserve banks. The board realizes that the operation of the Federal Reserve check clearing system has in a number of cases deprived banks of an income from exchange on checks which they have hitherto enjoyed, but as they are enabled to offset checks drawn upon

themselves sent them by the Federal Reserve banks with checks drawn upon other banks and are permitted, furthermore, to cover by shipments of currency at the expense of the Federal Reserve Bank, no actual hardship is imposed. An amendment permitting a charge of not exceeding 10 cents per \$100 or fraction thereof, based on the total of checks and drafts presented at any one time for collection and payment of checks and remissions therefor by exchange or otherwise, would, in the opinion of the board, be construed by the banks as a definite suggestion that they impose such a charge, with the result that eventually these charges would be generally made, not only as against checks coming in from a distance, but even against checks presented by payees residing in the community where the bank is located. While banks would no doubt pay checks for their own depositors without any charge, it is entirely possible that many of them would avail themselves of the opportunity of enforcing this charge against checks presented by payees who are not depositors. This would impose a hardship upon those of the poorer classes who are not bank depositors.

"The board would call attention also to the fact that for some years past actual payees of checks drawn upon country banks have been able in many cases to collect them without exchange charges, which have been absorbed by their depository banks, which have in turn been reimbursed by balances kept with them by the country banks. Immediately upon the passage of Senate Bill No. 8, or no later in any event than November 17 next, no bank balances will count as reserve except those with Federal Reserve banks, so that facilities for free collection will no longer be afforded by member banks, and the result would be that many individuals, firms, and corporations would be paying exchange charges of one-tenth of 1 per cent upon checks which they have hitherto been able to collect at par.

"The enactment of the proposed amendment, in the opinion of the board, would, because of the injury it would work to holders of bank checks, create a strong protest all over the country, which would be far stronger than the pressure that is now being brought to bear for its enactment."

Governor Harding enclosed with his reply a resolution adopted by the Governors of the Federal reserve banks at their Tenth Conference, in which they "earnestly urged the Federal Reserve Board to use every legitimate means possible to prevent the enactment of the Kitchen Bill when introduced into Congress, and to promptly develop and put in the fullest operation the Federal reserve collection system."

Reserve Banks Plan to Have Par Collection Universal.—While the state bankers have been exerting every influence at their command to perpetuate exchange charges, the Federal Reserve Board and the reserve banks have been working steadily toward the extension of par check collections, looking forward to the time when every check will pass at par throughout the country. The first step toward a universal par list was taken by the Boston Reserve Bank, which as has been said, took over the Boston Clearing House. With 97 per cent of the aggregate amount of checks already passing at par, it was not difficult to inaugurate a system by which all checks would be received at par, the reserve bank collecting the samll percentage drawn on non-assenting banks through express companies or neighboring banks. The Reserve Bank of San Francisco, with the inauguration of the compulsory collection system, announced that it would accept and collect checks at par on any bank in the district whether it had assented to the plan or not. Perhaps the most significant step, however, is that taken by the New York Reserve Bank, which announced that on and after April 1, 1917, it would receive for collection at par checks on all banks and trust companies within its district. At that time some 935 banks, out of a total of 1049 banks of all classes within the district, were remitting at par. The reserve bank declared, that justice to the great majority of banks demanded that the 114 recalcitrants should be forced to honor their checks at par, and that the Federal Reserve Bank would arrange to collect checks upon the non-assenting banks by having them presented by an express company for payment at the counters of these institutions. There could be no objection, the Reserve Bank pointed out, to be required to cash checks drawn by their depositors, regularly endorsed and presented by responsible persons at the paying teller's window. It was a legal and moral obligation which the bank must meet. Although the plan would involve considerable expense, in proportion to the items which had to be collected in this manner, yet on the whole the advantage to the 16,000 banks which were using the reserve collection system would far outweigh the added cost.

The country bankers of New York State were not slow in

accepting the challenge of the reserve bank. Some weeks after the inauguration of the plan, the Federal Reserve Bank of New York received for collection a few checks on non-assenting banks, which checks had stamped thereon the words "not payable through an express company." As the New York Federal Reserve Bank declared

. . . this stamp is being used by some of them in the expectation that they may be enabled thereby to pay checks drawn upon themselves at less than their face value to the detriment of business men and others who received such checks. . . . Of the total banks in the New York Federal reserve district 99.6 per cent, using figures on the basis of their resources, are paying checks drawn on them at their face value. The collection system of the bank is, therefore, so clearly complete that it will be carried to completion with the least possible delay. In order to accomplish this result, and thereby give to the customers of all banks whether or not they are members of the Federal reserve system, the benefits of a direct, economical and scientific method of collecting checks, special agencies will be promptly established wherever necessary to handle all checks carrying the restrictive stamps."

Not to be outdone, the bankers induced the Legislature of New York to pass a bill, intended to protect the right of state banks to collect exchange charges on their checks when remitted for collection. The bill, which is now in the hands of the Governor, makes it a crime, punishable with a \$1,000 fine, to compel a banking institution of the state to surrender its right to make a reasonable charge for domestic exchange, or to pay checks drawn on it by any other means than cash in its own office. The presenting of checks at the offices of the drawee bank through express companies "or otherwise," would constitute a crime. This grotesque bill will probably not receive the signature of the Governor, but if he should sign it, there is no doubt, in the minds of Federal reserve officials, that it will be promptly declared unconstitutional by the Federal Courts as an unlawful restriction of interstate commerce. A test case will doubtless be instituted concerning a check forwarded for collection to the New York Federal Reserve Bank from some other Federal

reserve district, and drawn upon one of the objecting New York State banks. In view of the very broad interpretation which the Supreme Court consistently has given to the interstate commerce clause, it is very unlikely that such a statute will stand the test of the Supreme Court's scrutiny. The only doubt concerns the power of the express companies under their charters to engage in such an activity. Although the express companies have engaged in the banking business to the extent of selling money orders, it might be held that their corporate powers did not extend to the collection of checks. The Federal Reserve Bank of New York was evidently anticipating such a condition when it announced that it would establish "special agencies" wherever necessary to make such collections. Whether the Federal reserve bank intends to use other banking institutions or entrust the work to responsible local citizens is not clear. Either plan would defeat the objections of the state bankers.

From the standpoint of power there is no doubt that the Federal Reserve Board has a tremendous advantage in forcing the state banks to honor their own checks. The most efficient collection medium is probably the post-office, which being a Federal institution would lie beyond the power of a State Court's injunction. As a matter of fact on July 20, 1916, the Secretary of the Treasury announced, at the request of the Federal Reserve Board and with his recommendation, that the Post Master General had issued instructions to post masters in towns and cities having no member bank, to accept from the Federal reserve bank, and to present and collect checks drawn upon non-member banks, which had refused to remit at par. The post masters were authorized to receive checks from the Federal reserve bank, present them at the counters of the state banks, collect the currency, and remit the proceeds to the Federal reserve bank of the district involved, at the expense of that institution. However, the new plan was never put into operation for on July 28th the Post Master General suspended his order until further notice. In announcing the suspension the Post Master General stated that it was made at the instance of the Federal Reserve Board, which desired further time in which to perfect details of the check collection plan before enlisting

the co-operation of the Post Office Department. No further action has been taken concerning the use of the Post Office in the collection of checks.

Analysis of State Bank Protests.—The protest of the state banks is based upon two grounds: first, that the elimination of exchange charges works a heavy decrease in their profits, rendering many state institutions unprofitable to their owners; and, second, that it is unfair and unreasonable and cannot be defended as a matter of principle.

No authoritative figures have been produced substantiating the allegations that the elimination of exchange charges will work ruin to the state banks. The results of an inquiry made by the President of the Ohio Bankers' Association of the country banks in that state are interesting, however, as throwing light upon the extent of the effect of the new system upon the profits of the country banks. President Sams in his annual address before the Association, delivered in September 1916, stated the results of his inquiry as follows: "We received prompt and very full replies and in many instances comments upon the subject of the inquiry all of which tended to show this to be one of the minor items of profits of the Ohio banks. The average profit of the banks reporting was a little over \$15 for the month of May 1916."

The argument that exchange charges are necessary to support the small country bank is not borne out by the experience in New England. Exchange charges on country checks have been practically unknown in New England for years under the very remarkable system developed by the country collection department of the Boston Clearing House. Over 97 per cent of the aggregate amount of all checks sent out for collection were remitted for at par. If the absence of exchange charges was destructive to the country bank, the results should be evident in New England. An examination of the sworn statements of earnings and expenses of the New England banks, as published by the Comptroller of the Currency, shows these institutions to be as profitable on the whole as those of any section of the country. Certainly the data thus far presented does not establish the fact that the abolition of such charges will ruin the

country banks. Even though it be granted for the sake of argument, that the revenue heretofore derived from exchange charges is necessary for the support of many country banks, it does not follow that the present system of charging exchange should be perpetuated.

The second ground upon which the country banks attempt to justify exchange charges has been well stated by Mr. W. J. Gray, Vice-President of the First and Old National Bank of Detroit:

"Those who favor the plan for eliminating this charge, the so-called exchange, overlook, I think, the fact that the bank does something more than merely paying a check over the counter. With the remittance, the bank is obliged to write a letter (or make out a credit ticket of some kind), affix a postage stamp, draw a draft on an acceptable point (or else place a credit on its books), all of which things would be unnecessary if the check were simply paid. It is quite evident then that the bank has done something beyond the ordinary. For this, ought not the bank to be paid, and ought it not be paid something by way of profit, beyond the mere cost of the service, that is the outlay for stamps, stationery, and clerical hire?

"I think I understand the meaning of the term 'exchange.' I define it, in homely phrase, as the price of money payable at a distant point. To buy exchange on New York is to buy a draft payable in New York. Under its machinery, a merchant in Portland who owes a debt payable in New York can at his own bank buy a piece of paper which will be good in New York for the amount of his debt. The primeval method of payment would be for him to ship the currency to New York. In such event, he would have to pay the shipping, insurance and other charges, but his expense will be much less if he buys a banker's draft. Theoretically, of course, the banker would be obliged to ship the currency to his New York correspondent to put him in funds with which to meet the draft. But as there would probably be some one in New York who wished to pay a debt in Portland, if the two debts were in the same amount, it would be unnecessary to ship any currency either way. At all events, it would only be necessary to ship the excess of the one debt over the other. The same reasoning applies to a series of transactions, only the net balance owing needs any remittance in currency.

"As the banker thus is not required to ship currency for each transaction, his charge for the service, or 'exchange', need not be the same amount as if he had actually to ship currency each time. Consequently the merchant in buying exchange need not pay the cost of shipping the entire amount, usually a small fraction, regulated in foreign exchange by demand and supply, and in domestic exchange apparently regulated by nothing. ***

"My personal view tends to the idea that the banks ought to get something for service in remittance, but that the charges should be regulated by the Federal Reserve Board. If the banks are doing something at an expense of postage, stationery and clerk hire, they ought not to be expected to give this to the public. Indeed, the Federal Reserve Board recognized this principle, for the cost of the plan is assessed against the banks, and not against the public who presumably are most benefited."

Mr. Caldwell Hardy, Chairman of the Board of Directors of the Federal Reserve Bank of Richmond, in an address before the Richmond Association of Credit Men, clearly stated the weakness of this argument:

"There is a strong justification for the elimination of the country bank charge. Many of them complain that it will be difficult for them to make dividends if they lose their incomes from exchange charges, but if this is the case, it demonstrates that there is little justification for their existence. If they can live only by a charge made on their customers' checks, given to city merchants and others, they are levying a tax indirectly on the business of their communities for the benefit of the few in the community who are stockholders in the bank. The income from collection charges has led these banks to permit local merchants to run their bank accounts on a losing basis to the bank, the loss being recouped through the collection charge made on the checks referred to above. The elimination of collection charges will compel the country banks to require their customers to keep their accounts on a reasonably remunerative basis to the banks, the banks in turn giving the customers a quid pro quo in the way of loans or otherwise."

He went on to point out that many large business concerns carried balances in New York, Chicago or other large cities, because drafts drawn on banks in such cities passed at par practically throughout the country. Under the Federal Reserve System this practice will no longer be necessary in order to make payment by a credit instrument that will pass at par.

"The ready availability, through this draft and collection system, of funds deposited with any member bank will be a strong inducement to large business interests, corporations and transportation lines to keep their funds more on deposit with the banks in their district, where they are located or operating. This will bring about equalization of deposits throughout the country, and be

of great benefit to many districts which contribute largely to the support of many large interests, but realize in many instances only limited advantages in return."

Mr. Charles S. Hamlin, former Governor of the Federal Reserve Board, in an address before the Virginia Bankers' Association, strikingly phrased the basic argument for the new collection plan when he said: "To oppose a national system of check clearing at par, is no more justifiable than to oppose the construction of a great free highway because a few owners of toll roads benefit by their continuance." Akin to such opposition, he said, was the opposition of the city of Erie, Pa., many years ago, to the transformation of the narrow-gauge Eastern Railroad into a standard-gauge road, thus making possible physical connection with the standard-gauge roads leading to the West, whose terminals were located in another section of the city. The joining of the two systems on a single standard-gauge the City of Erie feared, would do untold damage by destroying the town's flourishing transshipment industry. "The new check-collecting system," he declared, "is merely an attempt to fix a standard-gauge along which the country's vast volume of checks may travel. The sooner banks adopt this system, the sooner the whole banking world will benefit."

It must be clearly understood that the Federal Reserve Board and the officials of the Federal Reserve Banks, in urging and insisting upon par collections, do not advocate that a member bank carry any account which is unprofitable after exchange charges are eliminated. On the contrary they have consistently taken the position that a depositor should be required to adjust his account upon a basis which renders it moderately profitable to his bank. If a country merchant carries an account which would be unprofitable, except for the fact that the bank can charge exchange for honoring the checks which this merchant sends to his jobber or wholesaler in a distant city, the cost of carrying the account is paid not by the depositor but by his distant creditor. No wholesale establishment charges higher prices to country merchants located in places where exchange charges are heavy solely because of the exchange charges which

must be paid in collecting the checks received from such customer. Exchange charges are like postage; they constitute a part of the general overhead expenses of a business, which are uniformly levied against the entire enterprise. The merchant doing business in a community where no exchange is charged is contributing his share to pay a portion of the wholesaler's expense for which he is in no way responsible.

In the last analysis, the customers of the retail merchant—the people at large—are paying these charges, the progressive community equally with the backward community; the thickly populated districts alike with those which are sparsely settled. Such a practice is no more defensible than one in which freight charges were ignored and goods were billed for the same price to the merchant doing business around the corner from the wholesaler, as that charged to the storekeeper thousands of miles away.

If any portion of the country banks find that certain of their accounts are unprofitable when exchange charges are eliminated, let them collect the deficiencies from such customers, either by requiring larger balances or by making a charge to cover any extraordinary expenses to which the bank is put. With a system of competitive banking—with rival banks seeking the accounts of local business men—competition between local banks, as a rule, can be depended upon to protect the country merchant against extortionate and unreasonable demands and charges by his bank.

To pass a law giving permission to all banks to levy exchange charges, without reference to whether they can be justified, would put an end to the entire par collection system. It would be a step backward made in the interests of a few banks at the expense of the business interests of the entire country.

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